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"A" Reorganizations–Statutory Mergers and Consolidations

William J. Vesely

THE STATUTORY MERGER or consolidation is one of the two principal types of reorganizations for acquiring the assets of another corporation in a tax-free transaction. The other principal method is the acquisition of assets solely for voting stock, a so-called "C" reorganization. To qualify a statutory merger or consolidation as an "A" reorganization under the *Internal Revenue Code*,[1] the transaction must be effected in accordance with a statutory procedure provided by the laws of a State or of a federal jurisdiction. A merger or consolidation under the laws of a foreign country will not qualify as an "A" reorganization although it may qualify as another type of reorganization.[2] The essential difference between a merger and a consolidation is that in a merger, one of the constituent corporations remains a continuing corporation called the surviving corporation, whereas in a consolidation, the continuing entity is a new corporation formed in the transaction.[3] The shareholders of the constituent corporations generally become shareholders of the surviving or new corporation, but this is not required as a matter of corporate law.

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The corporate and tax consequences are essentially the same whether the transaction is a merger or consolidation. For ease of presentation only mergers will be discussed in this article. Although a merger can include any number of corporations, it will be assumed that only two corporations are involved.

By operation of law all the assets and liabilities of the merged corporations become the assets and liabilities of the surviving corporation.[4] Ordinarily this takes effect upon the filing of the merger agreement with the appropriate State official or, if the applicable

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[1] INT. REV. CODE OF 1954, § 368(a)(1)(A) [hereinafter cited as CODE].

[2] Treas. Reg. § 1.368-2(b) (1955); Rev. Rul. 55-305, 1955-1 CUM. BULL. 345.

[3] *E.g.*, OHIO REV. CODE ANN. § 1701.78(A) (Page 1964). Hereafter, Ohio law will be used to exemplify State statutory merger or consolidation rules.

[4] *Id.* §§ 1701.81(A)(4), (6).

law permits,[5] upon the effective date specified in the agreement. The shareholders and security holders of the constituent corporations have such interests in the surviving corporation as the merger agreement establishes. The constituent corporation, which goes out of existence without formal dissolution proceedings, is merged into and continues in the surviving corporation.[6]

I. TAX ADVANTAGES OF "A" REORGANIZATION

The principal tax advantage of an "A" reorganization is the freedom allowed in choosing the consideration which may be used in the merger. The stock issued by the surviving corporation, or by its parent if a subsidiary is used, can be preferred or common, voting or nonvoting. Debt securities, promissory notes, other property or even cash may be used subject to compliance with the continuity of interest requirement.[7] Where consideration other than stock or qualifying securities is used, so-called "boot," gain realized by any shareholder will be subject to tax and some part or all of it may be taxed as a dividend.[8] But unlike the "C" reorganization, the use of "boot" will not by itself disqualify the reorganization.

The merger affords secondary but important tax advantages with respect to handling expenses of the transaction, paying claims of dissenting shareholders, disposing of unwanted assets to shareholders before consummating the merger and redeeming or repurchasing shares before the merger. In a "B" or "C" reorganization the transferee corporation must not pay the expenses incurred in the transaction by the transferor. Otherwise the "solely for voting stock" requirement will not be met and the reorganization will not be tax free.[9] In a "C" reorganization the cash retained to pay expenses plus that needed to pay claims of dissenting shareholders may risk violating the "substantially all the properties" test.[10] This

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[5] *Id.* § 1701.80(B).

[6] *Id.* §§ 1701.81(A)(1), (2).

[7] *See* text accompanying notes 13-22 *infra.*

[8] CODE §§ 354, 356(a).

[9] This rule has its source in Helvering v. Southwest Consol. Corp., 315 U.S. 194 (1942). Although other cases have held that this rule does not forbid the acquiring corporation from paying reorganization expenses, the Internal Revenue Service adheres to this strict position. *See* B. BITTKER, FEDERAL TAXATION OF CORPORATIONS AND SHAREHOLDERS 550-51 (2d ed. 1966).

[10] *See* Rev. Proc. 66-34, 1966-2 CUM. BULL. 1232, which, for advance ruling purposes, requires that not less than 90 percent of "net assets" must be transferred. Expenses of the transaction and claims of dissenters are not treated as liabilities in computing net assets.

requirement of a "C" reorganization also may preclude a prior redemption of preferred stock, or a purchase by the transferor corporation of part of its common stock, whereas this could be done in a merger. In addition, in several special situations involving mergers of two corporations where one owns stock of the other which stock it acquired either independently of or for the purpose of effecting the subsequent merger, the merger may give the desired tax-free transaction while an attempted "C" reorganization would not.[11]

II. ADDITIONAL REQUIREMENTS FOR QUALIFICATION

In addition to the statutory requirements, two judicially developed requirements must be met to qualify a merger as a reorganization. These are (1) "continuity of proprietary interest," which means that the stockholders of the two corporations, after the merger, must have stock interests in the surviving corporation representing a substantial part of the value of their stock interests in the constituent corporations before the merger, and (2) "business purpose," which essentially means that the transaction must have some bona fide business purpose as distinct from a purely tax purpose, or a mere change in form without a business reason.[12]

A. Continuity of Interest

Every type of reorganization, with the possible exception of recapitalizations (type "E"),[13] must satisfy the continuity of interest test. The minimum continuing stock interest needed to satisfy this requirement in a merger can not be expressed precisely. Stock having a value of 20 percent or less of the stock interest held before the merger clearly is not enough.[14] The Internal Revenue

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[11] *See* text accompanying notes 36-47 *infra.*

[12] Southwest Natural Gas Co. v. Commissioner, 189 F.2d 332 (5th Cir. 1951) (no continuity of interest where only 1 percent of the consideration received was common stock; the remaining 99 percent consisted of cash, bonds and the assumption of liabilities); Banner Mach. Co. v. Routzahn, 107 F.2d 147 (6th Cir. 1939) (no continuity where stock was worth $96,000 and other assets received were $500,000). *But cf.* Miller v. Commissioner, 84 F.2d 415 (6th Cir. 1936) (sufficient continuity of interest existed where 25 percent of the consideration received was stock). *See also* B. BITTKER, *supra* note 9, at 508-16. Nonstatutory tests have been exhaustively covered in a number of published articles. *See, e.g.,* Sapienza, *Tax Considerations in Corporate Reorganizations and Mergers*, 60 NW. U.L. REV. 765, 779-84 (1966).

[13] The Tax Court has held that continuity of interest is not required in a recapitalization. Alan O. Hickok, 32 T.C. 80 (1949), *nonacquiesced in*, 1959-2 CUM. BULL. 8.

[14] MacLean, *Creeping Acquisitions*, 21 TAX L. REV. 345, 353 (1966).

Service will rule in advance that there is sufficient continuity of interest if at least 50 percent in value of the consideration received by the shareholders of the acquired corporation for their stock consists of stock of the acquiring corporation, or of its parent.[15] This 50 percent standard, while understandable for administrative purposes, is more restrictive than the standard imposed by the courts which have found the necessary continuity where the continuing stock interest was well below this percentage.[16] It has been suggested that if an advance ruling were not obtained in a transaction, and if the question were referred to the National Office for technical advice in connection with a field audit of the transaction, the National Office would advise that a continuing stock interest of at least 40 percent would be sufficient.[17]

The shareholders of the constituent corporation are treated as a group in determining whether there is continuity. For tax purposes it is not essential that each shareholder receive the same kind of consideration. Some may receive stock while others receive cash, securities, or other nonproprietary interests.[18]

Debt securities issued by the surviving corporation, whether or not they technically qualify as "securities" which could be received in exchange for other securities without recognition of gain, are not a proprietary interest for this purpose.[19] Only stock of the surviving corporation, or its parent, qualifies. It is particularly essential in a merger always to keep in mind that although securities may be received in exchange for other securities without recognition of gain, it does not follow that they qualify as equity in determining whether there is continuity of interest.

The shareholder approval required by the State merger statutes will assure that dissenting shareholders[20] cannot cause a violation of the continuity of interest requirement, except possibly in a merger of two corporations where one owns a substantial stock interest in the other. In most circumstances a merger would not be practicable if dissenters constituted a significant minority interest, and it is customary to include a limiting condition in the reorganization

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15 Rev. Proc. 66-34, 1966-2 CUM. BULL. 1232.

16 At one time, the Service apparently would rule that a 25 percent common stock interest was sufficient. *See* MacLean, *supra* note 14, at 355-56.

17 *Id.* at 356.

18 Rev. Rul. 66-224, 1966-2 CUM. BULL. 114.

19 Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U.S. 462 (1933); Courtland Specialty Co. v. Commissioner, 60 F.2d 937 (2d Cir. 1932).

20 *E.g.*, OHIO REV. CODE ANN. § 1701.78 (Page 1964).

agreement to permit termination of the transaction if dissenters exceed some specified percentage interest. A purchase or redemption of outstanding stock before the merger to eliminate a substantial shareholder interest which might be expected to dissent does not necessarily assure continuity in that, under the step transaction doctrine,[21] such interest may have to be considered in determining the stock interest before the merger which must be represented by stock in the surviving corporation.

The sale or taxable exchange after the merger of the stock received in the merger also may affect continuity.[22] A commitment to sell most or all of the stock would cause the merger to be taxable. Even without such a commitment, a sale of stock soon after the merger which reduces the stock retained below the quantum necessary to satisfy continuity would jeopardize tax-free treatment unless the sale clearly was independent of the merger.

B. *Business Purpose*

All reorganizations, including mergers, must have a valid business purpose.[23] In essence this means that in addition to being a merger in form, the transaction must serve some substantive purpose other than a tax purpose. Ordinarily, the general purpose of acquiring an additional business to be continued by the survivor is sufficient. At one time the Internal Revenue Service attempted to impose a "continuity of business enterprise" requirement in addition to the business purpose test, taking the position that it was necessary for the surviving corporation to continue essentially all of the businesses engaged in by the acquired corporation before the merger. The Service has retreated from this position and now a continuation of some business activity is adequate.[24]

The business purpose requirement would seem to inhibit only mergers of related corporations since there will almost always be valid business reasons where there is a merger of unrelated corporations. The question of whether or not the business purpose must be that of the corporation, or whether a shareholders' purpose is

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21 *See* text accompanying notes 36-47 *infra.*

22 Rev. Proc. 66-34, 1966-2 CUM. BULL. 1232; *see* Sapienza, *supra* note 12, at 781-82.

23 For a recent case illustrating this doctrine, see Naeter Bros. Publishing Co., 42 T.C. 1 (1964), *acquiesced in*, 1964-2 CUM. BULL. 6 (administrative saving held to be a valid business purpose).

24 Lesser, *Business Purpose Revisited*, U.S.C. 14TH INST. ON FED. TAX. 513 (1962); Sapienza, *supra* note 12, at 782.

sufficient, has not been totally resolved, but it would appear that a non-tax avoidance purpose of the shareholders should be sufficient.[25]

III. TAX CONSEQUENCES TO SHAREHOLDERS AND SECURITY HOLDERS

To qualify for the tax-free rules applicable to reorganization exchanges, the exchange of stock and securities must be made pursuant to the plan of reorganization, and the stock and securities must be those of a corporation which is a party to the reorganization.[26] Shareholders who receive only stock in the merger do not realize gain or loss on the exchange. Security holders who receive stock or securities do not realize gain or loss unless the face amount of securities received exceeds the face amount of securities surrendered. Notes and other debt instruments must have a relatively long term to qualify as securities. There is no precise standard. Short term notes and notes of 5 years and less have been held not to be securities.[27] Promissory notes and bonds of 10 years or longer have been held to be securities.[28] Stock rights and stock warrants do not qualify as stock or securities.[29]

Gain is recognized to the extent that cash or other nonqualifying property is received, and to the extent that any securities received have a face amount in excess of the face amount of securities surrendered, or if no securities are surrendered.[30] The statute contemplates that gain is taxable as capital gain or as ordinary income depending upon whether it has the effect of a distribution of a dividend. The position of the Internal Revenue Service, which has support in the court decisions, is that gain always is taxable as a dividend to the extent of the earnings and profits of the acquired corporation.[31]

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[25] *See, e.g.*, Parshelsky's Estate v. Commissioner, 303 F.2d 14 (2d Cir. 1962); Lewis v. Commissioner, 176 F.2d 646 (1st Cir. 1949); Wolf Envelope Co., 17 T.C. 471 (1951).

[26] CODE §§ 354, 368(b).

[27] LeTulle v. Scofield, 308 U.S. 415 (1940); Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U.S. 462 (1933); Neville Coke & Chem. Co., 3 T.C. 113 (1944), *aff'd*, 148 F.2d 599 (3d Cir. 1945).

[28] Commissioner v. Freund, 98 F.2d 201 (3d Cir. 1938); Daniel H. Burnham, 33 B.T.A. 147 (1935), *aff'd*, 86 F.2d 776 (7th Cir. 1936); *see* Rev. Rul. 59-98, 1959-1 CUM. BULL. 76 (ruled that secured bonds with an average life of 6½ years are securities).

[29] Treas. Reg. § 1.354-1(e) (1955).

[30] CODE § 354.

[31] *Id.* § 356. The Service's position is based on Estate of Bedford, 325 U.S. 283

The shareholders and security holders carry over to the stock and securities received their basis for the stock and securities surrendered. If any gain is realized, this basis first must be increased to reflect such gain, including that taxed as a dividend, and reduced by the amount of cash and fair market value of other property received plus any loss realized on the exchange.[32] Nonqualified property which resulted in recognition of gain takes its fair market value as its basis. Where gain results from receipt of securities in excess of the face amount permitted, a proportionate part of the basis for such securities is determined by reference to their fair market value. Where more than one class of stock or securities is received, basis is allocated in proportion to their relative fair market values.[33]

IV. TAX EFFECT ON CORPORATIONS

The acquiring corporation in the merger carries over to the properties it receives the basis of the acquired corporation for such properties.[34] This is so whether it receives such properties directly or whether they were contributed to it by its parent which received them in the merger.

The acquiring corporation in a qualifying statutory merger also succeeds to the various tax attributes of the acquired corporation such as net operating loss carryovers, earnings and profits, methods of accounting, pension and profit sharing plans and other items as set forth in the *Code.*[35]

V. STEP-TRANSACTION DOCTRINE

Some interesting questions can arise involving unexpected application of the "continuity of interest" doctrine where, by reason of the "step-transaction" doctrine, several related steps are treated as a single transaction. A form of corporate transaction that appears to be reported frequently in the financial pages is the cash tender offer to shareholders, culminating in a purchase of a substantial block of stock, followed soon thereafter by a merger.[36] The same

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(1945), but there are contrary lower court decisions. Sapienza, *supra* note 12, at 790-91.

32 CODE § 358.

33 Treas. Reg. §§ 1.358-2(a)(2)-(4) (1955).

34 CODE § 362(b).

35 *Id.* § 381.

36 For example, note the acquisition of Wilson & Co., Inc., by Ling-Temco-Vought,

result may follow the purchase of a block of shares from a substantial holder.[37] If in such circumstances the initial purchase of shares were considered to be an integral part of the total transaction then the stock received in the merger by the shareholders of the acquired corporation may represent substantially less than the 50 percent stock interest which, at least for ruling purposes, the Internal Revenue Service requires for continuity.[38] Clearly there would be continuity if the initial purchase of shares was an independent transaction and if the only consideration given in the merger, other than stock, was cash paid to dissenting shareholders.

The existence of a number of substantial transactions of this kind would indicate that the initial purchase of shares, although made with the intention of effecting the ultimate merger, ordinarily is considered to be a separate step for tax purposes.[39] This result is in accord with the view that the step-transaction doctrine should be invoked only if commitments to perform the later steps are in existence before the first step is taken. Recent developments make it questionable whether the doctrine can be interpreted so restrictively, and it may well apply wherever the steps are part of a single plan for effecting a particular end result, whether or not there are preexisting legally binding commitments.[40]

If the acquiring corporation at the time of the merger owns at least the requisite 80 percent of the acquired corporation's stock, for tax purposes the merger will be viewed as a liquidation of the acquired corporation under the parent-subsidiary liquidation provision of the *Code*.[41] New bases will be assigned to the assets received by the parent in liquidation of its stock interest if the requirements of section 334(b)(2) are met. If not, the acquiring corporation will take over the basis of the acquired corporation for such assets.[42]

Whether stock received by the minority shareholders in such a

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Inc., in 1967, in which, through a series of separate steps, 53.17 percent of Wilson's stock was acquired by purchase within 4 months before the approval of the merger.

[37] An example is the United Utilities, Inc., acquisition of North Electric Co., in 1967, the merger having been preceded by the purchase of a 52 percent stock interest from the L.M. Ericsson Telephone Co. of Sweden.

[38] *See* text accompanying note 15 *supra*.

[39] The consummation of both transactions referred to in notes 36 and 37 were conditioned upon receipt of favorable tax rulings as to the qualification of the merger as a reorganization.

[40] *See* South Bay Corp. v. Commissioner, 345 F.2d 698 (2d Cir. 1965), *cited in* MacLean, *supra* note 14, at 356; Sapienza, *supra* note 12, at 784 n.65. For the more restrictive view, see Commissioner v. Gordon, 36 U.S.L.W. 4454 (U.S. May 21, 1968).

[41] CODE § 332; Treas. Reg. § 1.332-2(d) (1955).

[42] CODE § 334(b)(1).

case is considered as having been received in a merger or in a taxable exchange apparently will depend upon the applicability of the step-transaction doctrine. If continuity of interest is lacking because of a prior purchase of most of the stock, the minority would recognize their gain or loss on receipt of the survivor's stock. If the prior purchase of stock was a separate transaction, the exchange of shares by the minority should be tax free.[43] Where the parent has held its stock interest in the subsidiary for some period of time, so-called "old and cold stock," or where the purchase, although recent, is not considered a step in the merger, it is apparently the Service's present policy to neutralize such stock and determine continuity solely by reference to the remaining outstanding stock.[44] A sizable bloc of dissenters thus could destroy the tax-free status of the merger. In such event the exchange would be taxable to all of the minority shareholders irrespective of whether they received cash or stock.

The merger will be treated as a statutory merger rather than a liquidation where the survivor owns less than the 80 percent stock interest necessary to qualify the transaction as a tax-free liquidation, subject to possible attack by the Service if the minority does not receive sufficient stock to establish continuity. It is important to note that if the assets of the company being acquired were transferred to the surviving corporation in a "C" reorganization, followed by liquidation of the acquired company, under the rule of *Bausch & Lomb Optical Co. v. Commissioner*,[45] the transaction would be viewed as a taxable liquidation. In effect, the parent is considered as having received the assets of the subsidiary allocable to its proportionate stock interest in liquidation of that interest rather than in exchange for its shares. The minority shareholders are treated as having received their shares in liquidation of their interest in the constituent corporation. Since the transfer to the survivor did not qualify as a "C" reorganization, the minority shareholders would not have received their stock pursuant to a plan of reorganization and gain or loss would be recognized.

Apparently if the combination is effected in the opposite direc-

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[43] The relevant authorities are collected and discussed in MacLean, *supra* note 14, at 357-58 and Trimble, *Creeping Control: An Analysis of Tax Problems of the Multi-Stage Acquisition*, 28 J. TAXATION 135 (1968).

[44] MacLean, *supra* note 14, at 354-55.

[45] 267 F.2d 75 (2d Cir. 1959); *see* Rev. Rul. 54-396, 1954-2 CUM. BULL. 147; Rev. Rul. 57-278, 1957-1 CUM. BULL. 124.

tion, that is a so-called "downstream" merger in which the corporation whose shares are owned by the other becomes the surviving corporation, the transaction will qualify as a tax-free merger.[46] This is clearly so where the parent owns more than 80 percent of the subsidiary's stock. If it owns a majority stock interest but less than 80 percent, and if the subsidiary's stock is its only asset, the Internal Revenue Service continues to hold to the position that the transaction in substance is a liquidation of the parent corporation resulting in taxable gain or loss to its shareholders.[47]

VI. DISPOSITION OF UNWANTED ASSETS

Normally there is no reorganization problem if the acquired corporation, before the merger, sells assets in which the acquiring corporation has no interest. But this may not be possible and distributing these assets as a dividend ordinarily is not workable. A possible solution would be to transfer the unwanted assets to a newly organized subsidiary of the acquired corporation and to distribute the subsidiary's stock to all or some of the shareholders — a so-called "spin-off." Subject to compliance with statutory requirements,[48] the receipt of such stock will be tax free to the shareholder, and there will be no tax to either corporation. It has been held, however, that a subsequent merger destroys the tax-free character of the previous spin-off for failure to satisfy the continuing active business requirement of section 355.[49] A merger in the opposite direction, in which the corporation distributing the stock is the survivor, was held not to disqualify the prior spin-off.[50] There is no reported case or ruling in which the Service has attempted in such a case to attack the tax-free character of the merger transaction itself although there might be support for this position in some circumstances.[51]

VII. CLASSIFICATION OF MERGERS AS "B" OR "C" REORGANIZATION

For any of a number of reasons the acquiring corporation may wish to keep the acquired corporation as a separate subsidiary. The

[46] Edwards Motor Transit Co., 33 P-H Tax Ct. Mem. ¶ 64,317 (1964); B. BITTKER, *supra* note 9, at 564-65.

[47] B. BITTKER, *supra* note 9, at 565; MacLean, *supra* note 14, at 349-50.

[48] CODE § 355.

[49] Curtis v. United States, 336 F.2d 714 (6th Cir. 1964).

[50] Mary Archer W. Morris Trust, 42 T.C. 779 (1964).

[51] *See* Sapienza, *supra* note 12, at 804-05 n.134.

reasons may relate to management of the business, the desire to insulate certain contractual relationships, for example labor contracts, the desire to avoid possible conveyancing and other problems inherent in transferring rights in real property, and, in some cases, the desire to avoid submitting the transaction to the shareholders of the acquiring corporation for approval.[52] One common technique is for the acquiring corporation to organize a new subsidiary and transfer to it the shares to be used in the acquisition. The newly organized subsidiary then merges with the corporation to be acquired, the shareholders of that corporation receiving such shares. The parent does not technically qualify as a party to the reorganization[53] in this kind of transaction so that, viewing the transaction as a merger, the receipt of stock would not qualify as a tax-free exchange.

The Internal Revenue Service tests this kind of transaction for qualification either as a "B" or a "C" reorganization: a "B" reorganization if the acquired corporation is the survivor in the merger;[54] a "C" reorganization if the newly organized subsidiary is the surviving corporation.[55] The more stringent requirements of a "B" or "C" reorganization, principally the use of only voting stock, of course must be met. The number of dissenting shareholders, if the transaction is a "C" reorganization, cannot be large else the "substantially all the properties" requirement may not be met. Interestingly enough, if the transaction is viewed as a "B" reorganization, there is apparently much wider latitude in the allowable number of dissenters and also in the acquired corporation's discretion to redeem or purchase its stock before the merger, provided the quantum of the stock interest which receives cash does not destroy continuity.

VIII. IMPORTANT NON-TAX CONSIDERATIONS

A number of key, non-tax considerations should be understood

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52 Under the corporation laws of most States, assuming the existence of authorized but unissued shares, a vote of the acquiring corporation's shareholders would not be required if it is not a party to the merger. The corporation law of Ohio, OHIO REV. CODE ANN. § 1701.84 (Page 1964), would require such a vote of shareholders only if, had the transaction been effected by a merger with the acquiring corporation, shareholder approval would have been required.

53 CODE § 368(b); Rev. Rul. 67-326, 1967 INT. REV. BULL. NO. 40, at 12. In order for the parent to be a party to the reorganization, the merger would have to be made directly with it, and then it could transfer the properties to its subsidiary.

54 Rev. Rul. 67-448, 1967 INT. REV. BULL. NO. 51, at 15.

55 Rev. Rul. 67-326, 1967 INT. REV. BULL. NO. 40, at 12.

in connection with mergers. Some are equally applicable to one or more of the other forms of reorganization. Some are unique to the merger form.

In a merger, by operation of law the surviving corporation succeeds to all the properties and rights of the constituent corporation.[56] It can not select only those it wants. As a practical matter, the "substantially all the properties" requirement of the "C" reorganization produces the same result. Correspondingly, the survivor takes over all liabilities of the constituent corporation by operation of law.[57] This is a significant point of distinction between a merger and a "C" reorganization where the acquiring corporation takes only those liabilities which it agrees to assume.[58]

An important distinction having tax consequences is the handling of payments to dissenting shareholders and the expenses of the transaction. In a merger these are liabilities of the surviving corporation by operation of law. Their payment has no tax significance. In a "C" reorganization payment by the acquiring corporation, as previously noted, is fatal to the reorganization.[59]

The "transfer by operation of law" attribute of mergers avoids considerable paper work required in a "C" reorganization. This can be particularly important to a corporation, such as a utility company, having a large number of real property interests of a diverse nature. Whether it effectively bypasses the need to obtain consent where transfer of property or contract rights requires consent of another party is an open question which can be answered only by analyzing the precise language of the consent provision. The merger technique discussed above, in which a newly formed subsidiary merges into the corporation being acquired, would seem to offer a ready solution where there are substantial problems in obtaining consents.

The corporate laws of most States require that a merger be authorized by the shareholders of both corporations except in the limited situation of parent-subsidiary mergers. Ordinarily, shareholder action is not required by the shareholders of the acquiring corporation in a "B" or "C" reorganization. The Ohio corporation law,

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[56] *See* note 4 *supra.*

[57] *Id.*

[58] The provisions of the Bulk Sales Law and other special statutes may impose liabilities not expressly assumed if there is not compliance with the provisions of those laws where applicable. Colborn, Fleming, Katcher & Merritt, *Buying and Selling a Corporate Business,* 10 W. RES. L. REV. 123, 160 (1959).

[59] *See* text accompanying notes 9-10 *supra.*

as amended in 1963,[60] eliminates this distinction by requiring authorization of the acquiring corporation's shareholders, whatever the form of acquisition, but only if the shares issued in the transaction represent at least one-sixth of the voting power immediately after the transaction is concluded.[61] The desire of the acquiring corporation to avoid such a shareholder vote, where the applicable law requires it, may be at least one reason for using the subsidiary merger technique previously discussed.

Where a publicly held company is the acquiring corporation, or in the less likely case where a closely held acquiring company takes over a publicly held company, compliance with the requirements of the Securities Act of 1933 is an important consideration. In general, disregarding exemptions, it is unlawful to offer to sell stock unless a registration statement has been filed with the Securities and Exchange Commission.[62] An actual sale cannot lawfully be made until the registration statement becomes effective and then only if the sale is preceded or accompanied by a qualified prospectus.[63] The Securities Act contains a number of exemptions from its registration requirements. The one most frequently relied on in issuing stock to a small group, including shares issued in acquiring a closely held corporation, is the private offering exemption.[64] There is no precise standard for determining whether an offering qualifies for this exemption. Several factors, of which the number of offerees is probably the most important, are relevant. The permissible number will vary depending upon the degree of financial sophistication of the offerees.[65] Even if the privacy standard is met, the offering will not be exempt if the offeree intends, or is reasonably likely, to redistribute to the public the stock received by him. To assure that this will not be done, it is customary to require an "investment letter" from the shareholders of the acquired corporation representing their intention to acquire the shares for investment and not with a view toward sale.

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60 OHIO REV. CODE ANN. § 1701.79(A) (2) (Page 1964) (applicable to mergers and consolidations); *id.* § 1701.84(A) (2) (applicable to combinations and majority share acquisitions).

61 This is the rule of the New York Stock Exchange for listed companies. N.Y.S.E. Company Manual A-284.

62 Securities Act of 1933, § 5, 15 U.S.C. § 77e (1964).

63 *Id.*

64 *Id.* § 4(1), 15 U.S.C. § 77d(1) (1964).

65 *See* Kaufman & Loeb, *Corporate Reorganizations — Selected Securities, Corporate and Tax Law Considerations in Choice of Form,* U.S.C. 16TH INST. ON FED. TAX. 199, 209-11 (1964).

Another key exemption provision, applicable to mergers and "C" reorganizations but not available for "B" reorganizations, is the "no-sale" rule.[66] This rule exempts from registration securities issued in an acquisition where the applicable law requires the shareholders of the corporation being acquired to authorize the transaction and such action is binding on all shareholders except dissenters. The net effect is that not only is registration avoided on issuance of the shares, but the shareholders receiving them, provided they are not controlling persons, as a practical matter have freedom to resell them.[67] Controlling persons, which may include the directors, officers, and substantial shareholders of the corporation being acquired, may not lawfully sell their shares without first registering them except to the extent the no-sale rule permits sale of a limited amount in so-called regular brokerage transactions.[68] In the "B" type of acquisition where this rule is not available, the common practice is to require an investment letter from all persons who receive unregistered shares. This effectively precludes any sale by them without registration, absent a change of circumstances, for at least several years.

Another incidental non-income tax consideration is the general inapplicability to mergers of State sales and transfer taxes, whereas such taxes are imposed on transfers of assets in "C" reorganizations. The State of California, which is one of a number of States which impose a sales tax on nonretail sales of assets as in a corporate transaction, apparently does not impose such tax in a statutory merger.[69]

IX. CONCLUSION

In summary, there are a variety of factors to consider in utilizing a statutory merger or consolidation, among which the following

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66 SEC Securities Act Rule 133, 17 C.F.R. § 230.133 (1968).

67 Sales by noncontrolling shareholders generally will be exempt under the first clause of section 4(1) of the Securities Act. See discussion of the position of such shareholders in Kaufman & Loeb, *supra* note 65, at 224-25; Stark, *Non-Income Tax Aspects of Corporate Reorganizations: A Check List of the Issues and Problems Involved*, N.Y.U. 24TH INST. ON FED. TAX. 1085 (1966).

68 The quantity sold within any 6-month period may not exceed, in the case of unlisted stock, 1 percent of the shares outstanding when the order to sell is placed and, in the case of listed stock, the lesser of 1 percent of such outstanding shares or the largest volume of trading within any one of the 4 weeks immediately preceding the placing of the order to sell.

69 Kaufman & Loeb, *supra* note 65, at 253-54.

support the use of the merger form rather than one of the other types of tax-free reorganization:

(1) Nonvoting stock, securities, notes, or cash may be used without disqualifying the merger as a reorganization.

(2) Some minor act or omission, for example, payment of another's expenses, ordinarily will not disqualify the entire reorganization.

(3) A minority group of shareholders is less able to obstruct the transaction by making it difficult to qualify as a tax-free reorganization.

(4) The continuity of interest requirement is less stringent.

(5) There is greater freedom to dispose of unwanted properties before the merger.

(6) The "transfer by operation of law" feature of a merger avoids the mechanics involved in a transfer of assets.

There are of course adverse features, of which the required assumption of all liabilities, without limitation, and the necessity under most State corporation laws to obtain shareholder approval, are perhaps the most burdensome. But on balance, the use of the merger form probably affords the parties greater flexibility in designing the transaction to accomplish their particular objectives.