



## Federal Tax ADVISORY ■

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### Mutual Company Reorganizations

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The merger of or into a mutual corporation would seem to be a great candidate for reorganization treatment. And generally that is true, with one huge exception. *Paulsen v. Commissioner*, 469 U.S. 131 (1985), ruled that the merger of a stock bank into a mutual bank was not a reorganization because the stockholder's equity was mostly turned into a bank account, which was not equity. Therefore, the merger failed the continuity of proprietary interest requirement.

That seems obvious enough, until you notice that the stock bank allowed its depositors as well as borrowers to have votes too, as if they were stockholders. And those voting rights continued after the merger. Why were those voting rights not indicative of stock continuity?

Again, the obvious answer is that while the voting rights may be characteristics of stock, for continuity purposes the equity received in the surviving corporation must have a substantial level of value, such as 40% of the merging company's equity value. *Paulsen* ruled that the continuity of value was in the bank accounts and they were not equity, even though they carried a voting right.

What if a mutual bank merges into a mutual bank and pretty much the only thing that could be continuing equity is the voting right? Rev. Rul. 78-286 ruled that was a good reorganization. Even though the accountholder's residual right to net liquidation proceeds was not substantial in amount, it was all the equity there was, and it continued on the survivor side of the merger.

Mutual company mergers are not as frequent as they were some years ago when savings and loans were scrambling to find corporate structures that would allow them to be more profitable. But the idea of voting interests that don't have much value, which began in the mutual world, can have many other applications.

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For example, sometimes creditors have voting rights: they did in *Paulsen*. If a corporation tries to acquire such a corporation in a reverse triangular merger, do the voting rights held by creditors of the target count in the determination of whether control of the target was acquired for voting stock? Probably.

So voting stock can pop up in unexpected forms and should be carefully analyzed when corporate events involving the issuer occur.

For additional information, call [Jack Cummings](#) at 919.862.2302.

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