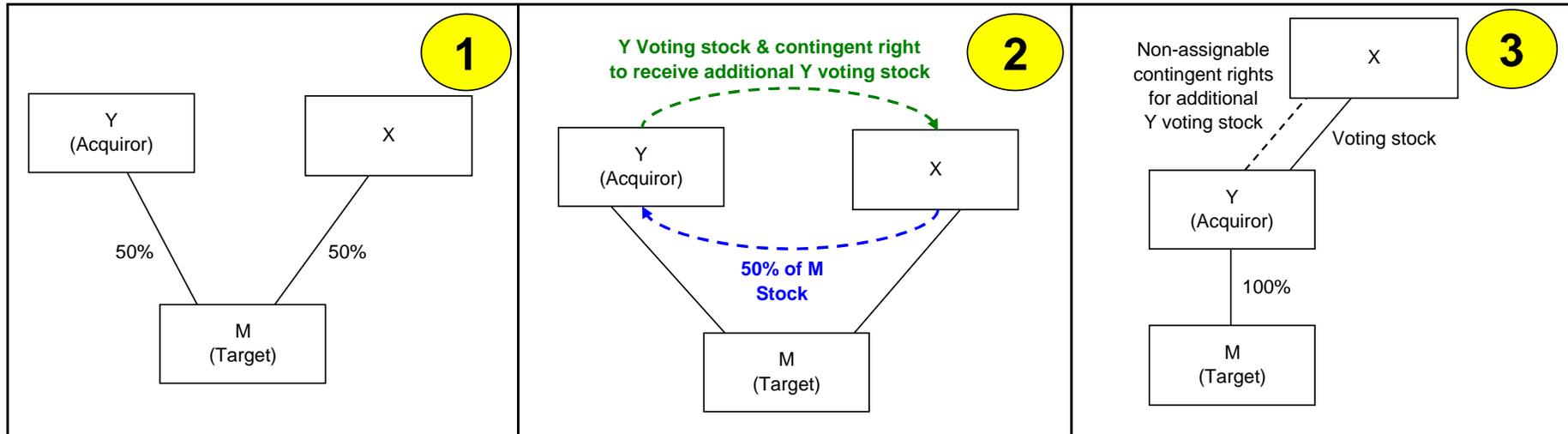


B Reorganization with Contingent Consideration

Initial Structure

B Reorganization

Ending Point



The capital stock of M corporation was owned equally by X corporation and Y corporation. For good business reasons Y was interested in acquiring X's one-half interest in M. Because M was closely held it was difficult to ascertain the fair market value of the M stock. Accordingly, X and Y entered into an agreement pursuant to which X transferred its one-half interest in M to Y in exchange for 40,000 shares of Y's voting stock. In addition, the agreement accorded X the right to receive additional shares of Y's voting stock in each of the succeeding 4 years following the date of the initial exchange in which M's net income exceeded a specified amount. If M's net income in the succeeding 4 years did not exceed the specified amount, no additional shares were to be received by X. The maximum number of additional shares of Y voting stock which could be received under the plan of reorganization was 20,000 shares. The right to receive such additional shares was not assignable and such right could give rise to the receipt of only additional voting stock.

The "control" requirement of section 368(a)(1)(B) is clearly satisfied since Y owns all of the stock of M immediately after the initial exchange. The only question remaining is whether the "solely for voting stock" requirement has been met. Whether this requirements has been met is dependent on the treatment to be accorded the contractual right of X to receive additional voting shares of Y based upon the net income of M. If such right is considered other property, the "solely for voting stock" requirement of section 368(a)(1)(B) will not have been satisfied nor will the requirements of section 354(a) have been met.

Under the facts of this case, the reorganization exchange has been fully consummated, except insofar as the contingent contractual right to receive additional voting stock of Y is concerned. This right is not assignable and it can give rise to only additional Y voting stock. Because of this and the fact that only voting stock has been and can be issued under the terms of the plan of reorganization, the initial receipt of X of 40,000 shares of Y voting stock and the later receipt by X of up to 20,000 additional shares of such stock that may be issued in the 4-year period following the initial exchange will satisfy the "solely for voting stock" requirement of section 368(a)(1)(B).