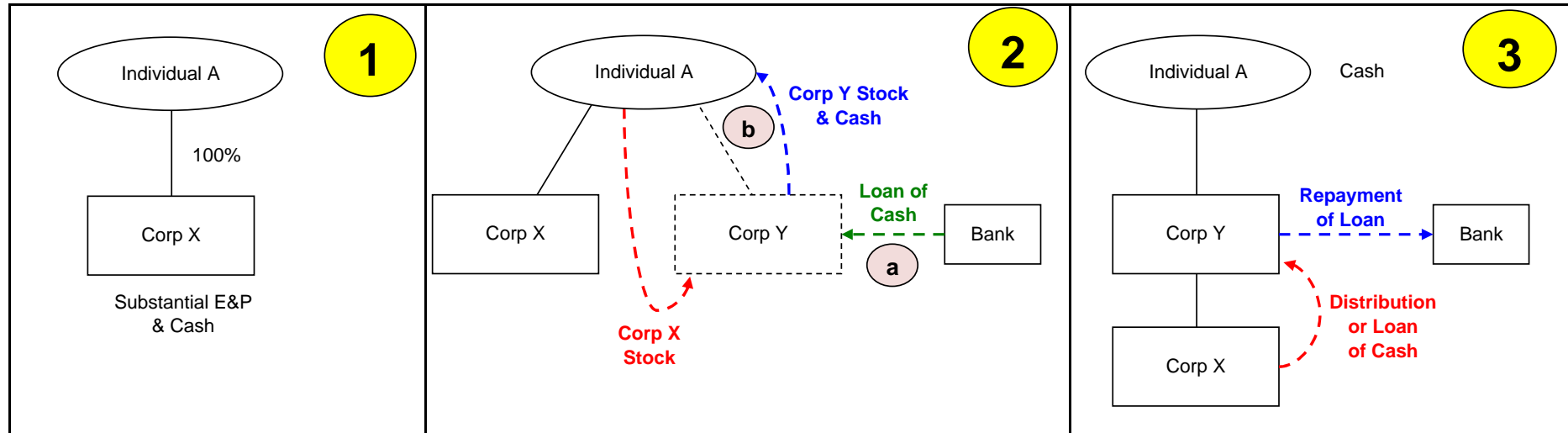


**301 Distribution Thru  
Conduit Entity**

Initial Structure

Holding Company Formation

Loan Repayment



Individual A owned all of the stock of corporation X, which is engaged in a profitable manufacturing business. Over the years, X has accumulated substantial earnings and profits but had never paid a dividend. A decided to broaden the business operations of X into other unrelated manufacturing endeavors, and to this end A determined that a holding company would be necessary to oversee and control a multifaceted operation. A also wanted to initiate some new business ventures as a sole proprietor but did not have the necessary cash without withdrawing funds from X. To accomplish these objectives, A transferred the stock of X to Y, a newly created corporation. In exchange, therefor, A received the stock of Y and 100,000x dollars that Y had borrowed from a bank. The obligation of Y to the bank was guaranteed by X and secured by a pledge of the X stock to be received pursuant to the overall transaction. Subsequent to the transaction, Y repaid the bank loan with funds received from X.

A distribution of the cash directly by X to A would have been a distribution within the terms of section 301. Although in the present case the cash distribution was arranged to be made by newly-organized Y corporation, this part of the transaction was in substance a disguised dividend distribution from X to A. The characterization of a distribution is not necessarily determinative for tax purposes and may be recharacterized to accord with the substance of a transaction. See *Waterman Steamship Corp. v. Commissioner*, 430 F.2d 1185 (5th Cir. 1970). Thus, the receipt of the 100,000x dollars by A is not governed under the provisions of section 351(b)(1). See Reg. 1.351-2(d) and 1.301-1(1). Also, the provisions of section 304(a)(1) do not have any application to this situation since the substance of the transaction involves no actual receipt by A of "property" (cash) that is required to be distributed by Y, the acquiring-transferee corporation. A will be treated as having received a dividend of 100,000x dollars from X to the extent provided in section 301.