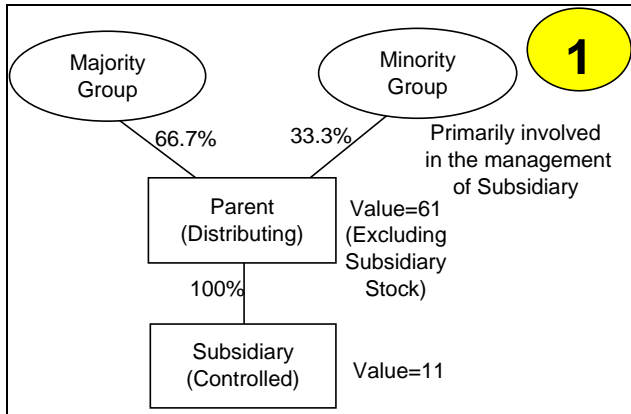
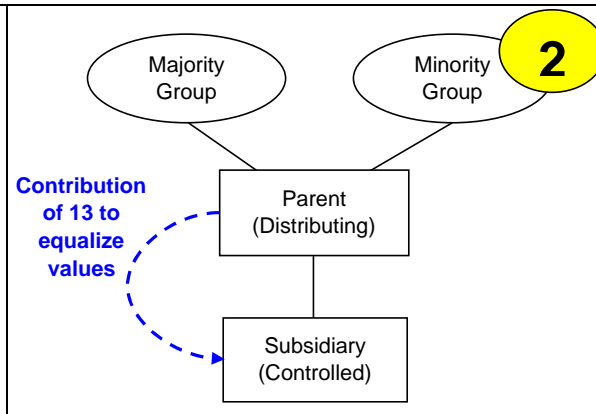


Pre-Split-Off Contribution Was Not a Device for the Distribution of E&P

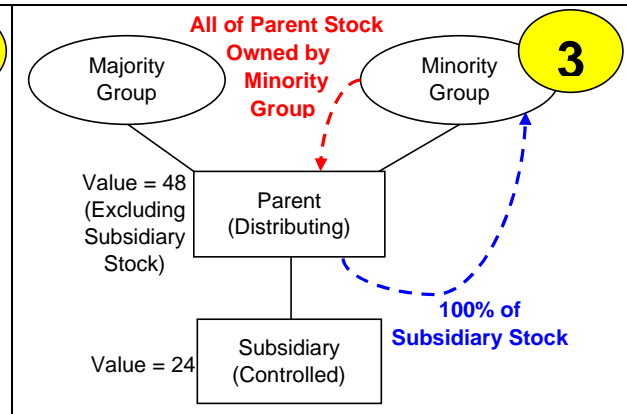
Initial Structure



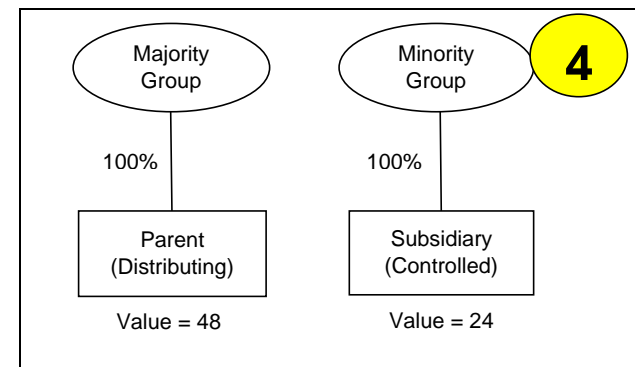
Contribution



Split-Off



Ending Point



Parent corporation, engaged for more than five years in the active conduct of a business, owned all the capital stock of Subsidiary corporation, which was also engaged for more than five years in the active conduct of a separate business. All the stock of Subsidiary had been acquired more than five years previously by Parent. A minority group of shareholders owning one third of the stock of Parent was primarily involved in the management of Subsidiary. In order to resolve managerial policy differences between this group of shareholders and the majority group, it was decided to distribute all the stock of Subsidiary to the minority shareholders in exchange for all their stock in Parent. Prior to the distribution, Parent made a capital contribution of 13x dollars to Subsidiary in order to equalize the value of Subsidiary's stock with the value of Parent's stock owned by the exchanging shareholders. The capital contribution did not cause changes of such character as to constitute the acquisition of a new or different business. After the contribution to capital and prior to the distribution of the stock of the subsidiary, the stock of the parent corporation had a value of 72x dollars and the stock of the subsidiary corporation had a value of 24x dollars. The one-third of the parent's stock owned by the minority shareholders was then surrendered in exchange for all Subsidiary's stock.

Section 355(a)(1)(B) provides that the transaction must not be used principally as a device for the distribution of earnings and profits of the distributing corporation or the controlled corporation or both. Although Parent made a large contribution to the capital of Subsidiary immediately before the distribution of Subsidiary's stock to the minority shareholders, the minority shareholders who received the controlled corporation's stock surrendered in exchange all their stock in the distributing corporation. This distribution, if it were considered taxable, would not result in dividend income to the shareholders receiving Subsidiary's stock because the exchange would be in complete redemption of all their stock interest in the distributing corporation and could be qualified under section 302(b)(3). Hence, the test prescribed by section 355(a)(1)(B) is satisfied. Accordingly, notwithstanding the large contribution to capital, there can be no device to distribute earnings and profits (that is, to convert dividend income into capital gains) because of the non pro rata distribution. Furthermore, the active business requirements of section 355(b) are met. Consequently, the distribution qualifies for tax-free treatment under section 355.