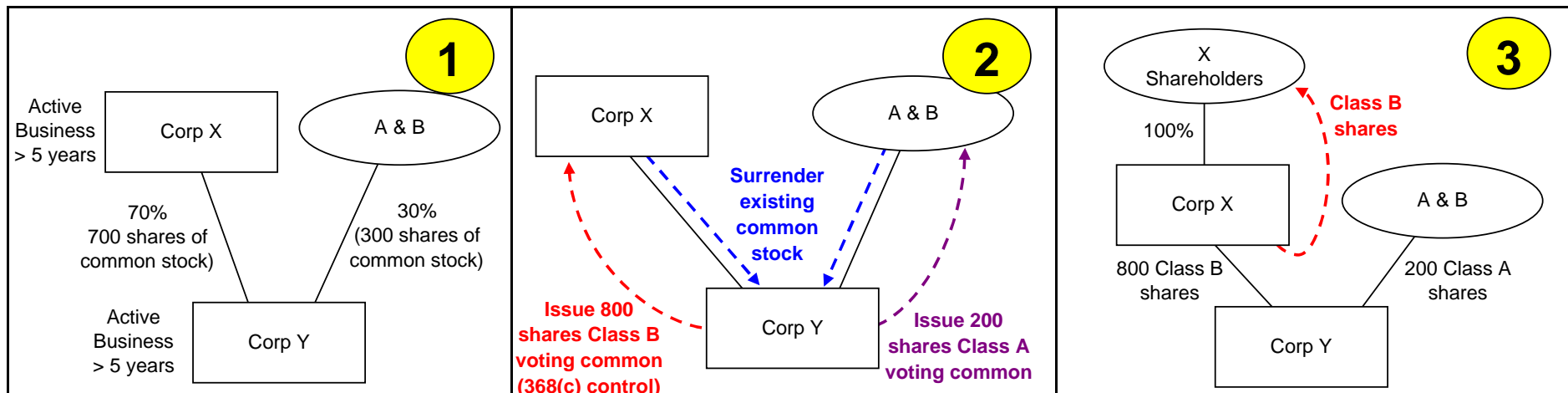


Initial Structure

Recapitalization

Spin-off



All of the outstanding stock of corporation Y was represented by 1,000 shares of \$100 par value common stock. Corporation X owned 70 percent of the stock of Y and the balance was owned by A and B who did not own directly or indirectly any stock of X. Both corporations had been engaged in the active conduct of their respective business for more than five years, and all of the stock of Y owned by X had been held by it for more than five years. Pursuant to a plan of recapitalization, Y issued 200 shares of \$150 par value Class A voting common stock to A and B in exchange for the 300 shares of \$100 par value common stock held by them. Y issued 800 shares of \$87.50 par value Class B voting common stock to X in exchange for the 700 shares of \$100 par value common stock held by it. The value of the stock received was equal to the value of the stock surrendered. The Class A and Class B common stocks had one vote each and were entitled to share in dividends paid by Y and in the assets of Y in the event of liquidation in proportion to the relative par values of the stocks. Thus the recapitalization did not change the proportionate interests of A, B and X in corporation Y but only altered the proportionate voting rights of the parties. After the recapitalization, the Class B stock owned by X represented 80 percent of the total combined voting power of all classes of common stock of Y entitled to vote. The purpose for the recapitalization of Y was to create a class of stock that will be available to key employees of Y and to facilitate the spin-off. After the recapitalization and for valid business reasons X distributed all of the Class B common stock of Y owned by it to its shareholders on a pro rata basis. Both X and Y continued the active conduct of their respective businesses. X acquired sufficient (80 percent) voting stock of Y immediately prior to the transaction to give it control of Y within the meaning of section 368(c). Since the stock was acquired in a transaction in which no gain or loss was recognized by reason of section 354, the requirements of section 355(b)(2)(C) were met and Y is treated as engaged in an active trade or business for purposes of section 355.

Ending Point

