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Suggested Treatment of Spin-Off Reorganizations

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A SUGGESTED TREATMENT OF SPIN-OFF REORGANIZATIONS

A spin-off reorganization occurs when Corporation *A* organizes a subsidiary, Corporation *B*, to which it transfers part of its assets in exchange for all the capital stock of *B*. *B*'s stock is then distributed to *A*'s shareholders without their surrender of stock in *A*.[1] After distribution of the controlled corporation's stock, the shareholders of the distributing corporation own stock in two independent companies. The distribution may be tax-free under Section 355 of the Internal Revenue Code of 1954,[2] which provides that if the transaction is not used principally as a device to distribute earnings and profits, and if certain other requirements are met,[3] the distribution of stock to the shareholders results in no recognition of gain or loss to them, assuming that no "boot" is distributed.[4]

The requirements of section 355 foreclose the otherwise tempting opportunity to transform dividend income into capital gain by transferring a company's liquid assets to a newly formed company and then liquidating the new company or selling its stock. Section 355 therefore attempts to preclude tax considerations from impeding business re-

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1 A split-off is similar to a spin-off, except that the shareholders surrender part of their stock in the parent corporation in exchange for stock in the subsidiary. In a split-up, the parent corporation transfers substantially all its assets to two or more corporations and then liquidates, its shareholders surrendering all of their stock in the parent and receiving the stock of the transferee corporations. When the distributing corporation transfers assets to the controlled corporation and then distributes the stock received in exchange, there is a reorganization under INT. REV. CODE OF 1954, § 368(a)(1)(D). Thus, the transferor corporation recognizes no gain or loss on the transfer under § 361(a), and, under § 362(b), the transferor's basis in the assets carries over to the transferee corporation. Unlike pre-1954 law, however, § 355 also encompasses non-reorganization spin-offs that involve only a distribution of the stock of an existing subsidiary corporation. This Note discusses only spin-offs that constitute Type D reorganizations.

2 Unless otherwise indicated, all textual references to section numbers and the "Code" relate to the Internal Revenue Code of 1954.

3 In addition to the general proscription of "devices," § 355 requires that (*1*) immediately before the distribution to the shareholders, the distributing corporation must "control" the corporation whose shares or securities are being distributed, *id.* § 355(a)(1)(A); (*2*) after the distribution, both corporations must be engaged in the active conduct of a trade or business that was actively conducted during the five-year period prior to the separation or acquired during that period in a tax-free transaction, *id.* § 355(b)(2); and (*3*) all of the controlled corporation's stock, or at least an amount constituting "control" within § 368(c), must be distributed to the shareholders, *id.* § 355(a)(1)(D).

4 Treas. Reg. § 1.358-2(a)(3) (1955) provides that the shareholder-distributee's basis after the distribution (assuming no boot is distributed) is the aggregate basis of his original stock and securities, allocated among the distributed and retained stock and securities in proportion to their respective market values.

organizations that are motivated by legitimate business reasons and are not aimed at avoiding taxes.[5] Ordinary income must be recognized, however, when the corporate separation is part of a plan that is, in effect, a dividend distribution.[6] But when the change in corporate organization is essentially a change in *form* only, the shareholders do not receive any additional economic interest from the stock distributions; they merely divide their investment among several corporate entities. As long as the assets remain in "corporate solution," and no subsequent disqualifying event occurs (such as a liquidation by one of the corporations or a sale of the distributed stock) the incidence of taxation is deferred.[7]

To qualify for nonrecognition treatment under section 355, spin-off transactions must now meet more rigorous conditions than existed under pre-1954 law. The Revenue Act of 1951 permitted tax-free treatment if two conditions were satisfied: first, each corporation involved must have intended to continue the active conduct of a trade or business after the separation; second, the transaction must not have been used principally as a "device" for distributing the earnings and profits of either corporation.[8] These two qualifications are retained as cornerstones of the present section, but 355 has complicated the law by adding an eighty-percent-control test and the five-year business history rules.[9] The ostensible purpose of the additional requirements was to

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5 *See* S. REP. No. 781, 82d Cong., 1st Sess. 57-58 (1951).

6 *See* Mintz, *Corporate Separations*, 36 TAXES 883 (1958).

7 Treas. Reg. § 1.355-2(c) (1955) provides in part:

> Section 355 contemplates a continuity of the entire business enterprise under modified corporate forms and a continuity of interest in all or part of such business enterprise on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the distribution . . . .

8 Revenue Act of 1951, ch. 521, § 317(a)(11), 65 Stat. 493. The 1951 Act restored tax-free treatment after spin-offs had suffered from more than a decade of Congressional disfavor. The Revenue Act of 1934 had treated *all* spin-off distributions as *dividends* in reaction to the well-known case of Gregory v. Helvering, 27 B.T.A. 223 (1932), *rev'd*, 69 F.2d 809 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935), where the taxpayer had transferred cash and marketable securities of her wholly owned corporation to a newly formed corporation in exchange for its stock, and then immediately liquidated the new corporation. The Board of Tax Appeals had held that meticulous compliance with the statute was sufficient to convey unintended capital gains treatment, and Congress attempted to close this bailout loophole by denying tax-free treatment to spin-offs. This turned out to be unnecessary, however, since the Supreme Court later reversed, holding that qualifying corporate separations must be motivated by a valid business purpose rather than an intent to avoid tax. The two conditions of the 1951 Act were inspired by the *Gregory* case.

9 INT. REV. CODE OF 1954, § 355(a)(1)(D) requires that if the distributing corporation does not distribute all of the controlled corporation's stock that it holds immediately prior to the distribution, then it must distribute 80% control within the meaning of § 368(c), provided that the Secretary's approval has been obtained. Section 355(b)(2)(B) requires that the business of each corporation must have been actively conducted for five

implement the pre-1954 non-device test and post-distribution active business test, as well as the business-purpose and continuity-of-interest tests which apply to all types of reorganizations.[10] A question arises whether the technical conditions for qualification leave enough room for flexible application when basic reorganization doctrines are satisfied. A spin-off of the non-California assets of Pacific Telephone Co., which has produced a split between the Ninth and Second Circuits, provides a convenient vehicle for analyzing this question.

I

THE PACIFIC REORGANIZATION: *Baan* AND *Gordon*

For several business reasons,[11] Pacific Telephone Company decided in 1961 to transfer its telephone communications business in Oregon, Washington, and Idaho to a separate corporation, and formed Pacific Northwest Bell Telephone Company (Northwest) for this purpose. Pacific transferred all its non-California assets and liabilities to Northwest, together with $110,000 cash, in exchange for all the shares of Northwest and an interest-bearing demand note for $200 million. Pacific then issued to each shareholder one transferable stock purchase warrant of Northwest for each share of Pacific he held.[12] The distribution plan required six stock rights plus a payment of sixteen dollars in exchange for one share of Northwest stock. The plan required Pacific to offer to its shareholders the right to purchase all Northwest stock on a

years prior to the distribution. Section 355(b)(2)(C) requires that neither business can have been acquired during the five-year period in a taxable transaction. Section 355(b)(2)(D) requires that control of any other corporation that was conducting either business must not have been acquired, directly or indirectly, in a taxable transaction.

10 Treas. Reg. § 1.368-1(b) (1955).

11 Among the reasons given for the separation were the size of the geographical area served by the company, the rapidly growing demand for telephone service, efficiency of operations, the need for closer relations with the public and its employees, and Pacific's desire for greater freedom to concentrate on California operations. Although these "business reasons" by no means make it obvious, the courts apparently assumed that Pacific could not have solved its problems as well by forming a separate division or subsidiary. One court has held that there must be valid business reasons for *both* the separation *and* the direct ownership of both corporations by the shareholders. Parshelsky's Estate v. Commissioner, 303 F.2d 14, 20 (2d Cir. 1962). *See also* Bonsall v. Commissioner, 317 F.2d 61 (2d Cir. 1963). *But see* Cohen, *Current Partial Liquidation and Spin-off Problems*, 41 TAXES 775, 777-79 (1963), for the view that this aspect of *Parshelsky* will have to be applied flexibly by the Internal Revenue Service and the courts.

12 Pacific retained the $200 million note of Northwest. Although the language of § 355(a)(1)(D)(ii) does not expressly authorize it, Treas. Reg. § 1.355-2(d) (1955) provides that securities may be retained.

pro rata basis. Any stock not purchased could be acquired by Pacific's parent company, AT&T, which owned 89.62 percent of Pacific's total voting shares. The plan left to the discretion of Pacific's management such matters as *how many* offerings of Northwest stock would be made before it was all distributed, *when* the offerings would be made, and *at what price* the Northwest shares would be offered to the shareholders.[13] The initial offering in 1961 distributed fifty-seven percent of the Northwest stock in exchange for six rights and sixteen dollars, at a time when the market value of the shares was twenty-six dollars. In 1963 the remaining forty-three percent was distributed for eight rights and sixteen dollars. In neither year did the distributee shareholders report as income any amount with respect to the issuance of the rights or the distribution of the stock. The Commissioner determined that the difference between the fair market value of the Northwest stock (twenty-six dollars) and the sixteen dollars per share paid constituted a taxable dividend under section 301.[14] The issue was contested first in the Tax Court in *Oscar E. Baan*[15] and then in the Second and Ninth Circuits in *Commissioner v. Gordon*[16] and *Commissioner v. Baan.*[17]

In the Tax Court and in both circuits of the court of appeals, the Commissioner made the following contentions:

(*1*) The five-year business history test of section 355(b)(2)(C) was not met.

(*2*) Pacific's three-year plan did not meet the distribution requirements of section 355(a)(1)(D).

(*3*) Pacific's use of stock rights and sixteen dollars cash consideration failed to meet the requirements of section 355(a)(1)(A) that "solely stock" be distributed "with respect to . . . stock."

A. *Five-Year Business History Test*

Under section 355(b)(2)(C), a corporation is considered actively engaged in business after the distribution only if its business was not acquired within the preceding five-year period in a transaction in which

13 These decisions were to be made according to the capital requirements of Pacific, but a letter sent to Pacific shareholders stated that the management anticipated complete distribution within three years.

14 Section 356(b) provides:

If—(1) section 355 would apply to a distribution but for the fact that (2) the property received in the distribution consists not only of property permitted by section 355 to be received without the recognition of gain, but also of other property or money, then an amount equal to the sum of such money and the fair market value of such other property shall be treated as a distribution of property to which section 301 applies.

15 45 T.C. 71 (1965).

16 382 F.2d 499 (2d Cir. 1967), *cert. granted,* 389 U.S. 1033 (1968).

17 382 F.2d 485 (9th Cir. 1967), *cert. granted,* 389 U.S. 1034 (1968).

gain or loss was recognized in whole or part. The Commissioner claimed that Pacific *had* acquired Northwest's business in a taxable transaction within the previous five years, since Northwest issued a demand note along with its stock, and that the note was "other property" within section 361(b).[18] According to section 355(a)(3), the Commissioner's view would make all of the *stock* distributed to the shareholders "other property" taxable as a dividend under section 356(b). The taxpayers argued that the note was a "security," which can be received without recognition of gain under 351(a) or 361(a). But the Tax Court declined to decide whether the note was "boot"; since the note was received in an inter-company transfer between members of an affiliated group of corporations filing a consolidated return, no gain would be recognized in any event because of the then-applicable consolidated return regulations.[19] Thus, any gain resulting from the transfer of business assets that might otherwise be subject to tax was *eliminated* under the consolidated return regnlations.[20]

The Commissioner argued that the Regulations merely provide for the *elimination* of gain, while section 355 requires *nonrecognition.* The Tax Court, however, refused to accept this distinction.[21] The issue was not resolved on appeal to the Second Circuit, perhaps because the applicable regulations had become obsolete.[22] The court instead approached the problem by applying its view of the *purpose* of the active business requirements of section 355(b)—the prevention of temporary investment of liquid assets in a new business or the purchase of a new business.[23] The five-year period, said the court, merely reduced the incentive to distribute the stock in place of a dividend. In this case,

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18 This section provides in part:

> If subsection (a) [no gain or loss on an exchange of property for stock between corporate parties to a reorganization] would apply to an exchange but for the fact that the property received . . . consists not only of stock or securities . . . but also of other property or money, then . . . (B) if the corporation receiving such other property or money does not distribute it . . . the gain, if any, to the corporation shall be recognized . . . .

19 Treas. Reg § 1.1502-31(b)(1)(i) (1955).

20 Oscar E. Baan, 45 T.C. 71, 93 (1965), *rev'd,* 382 F.2d 485 (9th Cir. 1967), *cert. granted,* 389 U.S. 1034 (1968), *and aff'd sub nom.* Commissioner v. Gordon, 382 F.2d 499 (2d Cir. 1967), *cert. granted,* 389 U.S. 1033 (1968).

21 It is doubtful that the Tax Court would reach the same result under the new consolidated return regulations, which provide that intercompany transactions result in a recognition of gain to the exchanging companies, with the gain merely deferred until a subsequent event. Treas. Reg. § 1.1502-13(c),(h), Example (2) (1966).

22 *Id.* The Ninth Circuit expressly declined to consider the elimination-nonrecognition issue. Commissioner v. Baan, 382 F.2d 485, 498 (9th Cir. 1967), *cert. granted,* 389 U.S. 1034 (1968).

23 *See* S. REP. No. 1622, 83d Cong., 2d Sess. 267-68 (1954). *See also* Jacobs, *The Anatomy of a Spin-off,* 1967 DUKE L.J. 1, 17-18 (1967).

it concluded, section 355(b)(2)(C) has no application since "no new business, no new assets, and no new corporation was acquired at all."[24] section 355(a)(1)(D)(ii) had been satisfied.

B. *Distribution of Control in a Single Offering*

Section 355(a)(1)(D) provides that the distributing corporation must distribute to its shareholders either all the stock or, with the Secretary's approval, eighty percent of the voting and nonvoting stock of the controlled corporation. The Commissioner argued that there is an implied requirement in section 355(a)(1)(D)(ii) that the distribution of stock constituting control occur in a single offering to the shareholders, and that this requirement was not met since Pacific's two offerings were separated by almost two years.[25] The Tax Court found no single offering requirement, and adopted the view that as of 1963, when more than eighty percent of the shares of Northwest had been finally distributed to Pacific shareholders, the control requirement of section 355(a)(1)(D)(ii) had been satisfied.

The Second Circuit upheld the Tax Court's *integrated transaction* approach. It said that the danger of periodic distributions of stock as substitutes for dividends could adequately be prevented by the "device" clause[26] and that any administrative difficulties presented by allowing more than one distribution could be remedied by new regulations.[27]

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24 Commissioner v. Gordon, 382 F.2d 499, 507 (2d Cir. 1967), *cert. granted*, 389 U.S. 1033 (1968). See Jacobs, *supra* note 23, at 18, for the view that when an acquisition of a business meets the continuity-of-interest requirements applicable to reorganizations generally, it should not be disqualified under § 355, even though there was some boot received in the transaction that results in gain to the transferor corporation under § 361 or to its shareholders under § 356.

25 The Commissioner argued that § 355(a)(1)(D) was designed to prevent periodic distributions of stock in the controlled corporation as a substitute for dividends and that whether the distributing corporation has retained more than 20% of the stock is determined immediately after the first distribution transaction. The Commissioner cited a number of administrative difficulties inherent in allowing more than a single distribution: the tax result would be left open for several years, and it would be difficult to define the "date of distribution" and to ascertain whether there was control "immediately before" the distribution.

26 382 F.2d at 508, citing Professor Bittker, who wrote that the presumable purpose of the limitation on retention of stock and securities was to prevent periodic distribution as a substitute for dividends, but that, as such, it overlaps and buttresses the "device" clause of § 355(a)(1)(B). Bittker went on to say:

> [I]t is not clear . . . why periodic distributions of small amounts of the controlled corporation's stock should be treated as a dividend, once the basic policy decision to permit a tax-free distribution of *all* of its stock and securities under § 355 was made.

B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 479 (2d ed. 1966).

27 Nothing in our opinion prevents the Commissioner from drafting reasonable

Since Pacific had distributed only fifty-seven percent of the Northwest stock after the initial offering, however, the Ninth Circuit held that the requirements of section 355(a)(1)(D)(ii) had not been met.[28] Although the court did not insist on immediate distribution, it took the view that if control is to be transferred in two distributions, they "must not extend over any greater period of time than is reasonably necessary considering the practical problems involved in completing such distributions."[29]

C. *Distribution "With Respect to Stock"*

The Commissioner asserted that Pacific had not met the requirement of section 355(a)(1)(A)[30] in that Pacific did not distribute the Northwest shares "with respect to its stock." His contention was that the sixteen dollar cash payment required of Pacific shareholders took the transaction out of the subsection, since the phrase "distributes . . . with respect to . . . stock" is used in the Code only to refer to distributions without consideration.[31] The Tax Court rejected this argument and, rather than finding a sale for cash consideration, treated the sixteen dollar payment as a contribution to capital required as a condition to receiving the stock.[32]

> Regulations limiting the time period within which the entire distribution must be made, or the number of transactions which may be involved, or specifying what advance notice must be provided the Service, or defining the statutory language . . . . But we are not prepared to apply retrospectively restrictions directed at evils which this case does not present.

Commissioner v. Gordon, 382 F.2d 499, 509 (2d Cir. 1967), *cert. granted*, 389 U.S. 1033 (1968).

28 "[F]ulfillment of the control requisite is to be adjudged as of the date of the initial distribution rather than by recourse to hindsight in each case after the transaction has been fully consummated." Commissioner v. Baan, 382 F.2d 485, 495 n.17 (9th Cir. 1967), *cert. granted*, 389 U.S. 1034 (1968).

29 *Id.* at 498.

30 "(1) GENERAL RULE.—If—(A) a corporation . . . (i) distributes to a shareholder, *with respect to its stock . . . solely stock* or securities of a corporation . . . which it controls immediately before the distribution . . . ." INT. REV. CODE OF 1954, § 355(a) (emphasis added).

31 *See* INT. REV. CODE OF 1954, §§ 301 (distribution of property), 305 (distributions of stock and stock rights), 307 (basis of stock and stock rights acquired in distributions), 311 (taxability of corporations on distributions), and 312 (effect of a distribution on corporate earnings and profits).

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> [S]ection 355 was intended to permit the receipt of such stock without tax even where the recipient paid nothing therefor, and . . . it would be a distortion of congressional purpose to impute an intention to impose the tax where the recipient was required in effect to contribute to the capital of the distributing corporation as a condition to receiving the distributed stock.

Oscar E. Baan, 45 T.C. 71, 91 (1965), *rev'd*, 382 F.2d 485 (9th Cir. 1967), *cert. granted*, 389 U.S. 1034 (1968), *and aff'd sub nom.* Commissioner v. Gordon, 382 F.2d 499 (2d Cir. 1967), *cert. granted*, 389 U.S. 1033 (1968).

The Second Circuit, though it agreed that the payment might be treated as a contribution to capital, preferred to hold for the taxpayers on the ground that, while the Code does not contemplate receipt of cash by a corporation in connection with a distribution, it does not prohibit such a transaction from falling within section 355. The court rejected the Commissioner's argument that the use of transferable stock rights plus the sixteen dollar cash payment requirement was likely to diminish continuity of ownership, by saying that continuity of interest is measured by what *actually* happened rather than by what might have happened.[33] Pointing out that over ninety-five percent of the shareholders exercised stock rights, the court concluded that the continuity requirement had been met.

The Ninth Circuit, on the other hand, accepted the Commissioner's argument that the use of stock rights with a requirement of cash payment might undermine continuity of interest. The Court again viewed the transaction prospectively, reasoning that upon the adoption of such a plan, it is conceivable that a substantial number of shareholders would choose to sell their stock rights rather than make the necessary cash payment.[34] The Ninth Circuit's holding seems unduly harsh, however, in view of Revenue Ruling 66-23,[35] in which the Service took the view that the continuity of interest requirements of the reorganization provisions are satisfied if the shareholder at the time of the reorganization has no preconceived plan or arrangement for disposing of the stock received.[36]

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33 Commissioner v. Gordon, 382 F.2d 499, 506 (2d Cir. 1967), *cert. granted*, 389 U.S. 1033 (1968).

34 Commissioner v. Baan, 382 F.2d 485, 495 (9th Cir. 1967), *cert. granted*, 389 U.S. 1034 (1968).

35 1966-1 CUM. BULL. 67. *See* Chester E. Spangler, 18 T.G. 976 (1952), *acquiesced in*, 1953-1 CUM. BULL. 6, where a split-off was held tax-free under the 1939 Code, even though the distributees sold the stock of both corporations after the distribution, because the Tax Court found that before the distribution they did not intend to make such a sale. *Accord*, Rena B. Farr, 24 T.C. 350 (1955). *See* B. BITTKER & J. EUSTICE, *supra* note 26, at 474 n.36. Presumably a non-prearranged sale of stock after the distribution that is not an integral part of the plan of reorganization would not run afoul of INT. REV. CODE OF 1954, § 368 (a)(1)(D), which requires that 80% control of the transferee corporation exist "immediately after" the transfer. Portland Oil Co. v. Commissioner, 109 F.2d 479, 489-90 (1st Cir.), *cert. denied*, 310 U.S. 650 (1940), held that the identical requirement in Revenue Act of 1928, ch. 852, § 112(b)(5), 45 Stat. 816 (now INT. REV. CODE OF 1954, § 351), is satisfied even if the shareholders have control only momentarily.

36 The Ninth Circuit's approach is impractical, since guessing at each shareholder's intentions is fruitless, especially when the distributing corporation is large and its stock is widely held. A representation of intention with respect to controlling shareholders, however, should be sufficient to satisfy Rev. Rul. 66-23, 1966-1 CUM. BULL. 67.

D. *Distribution of "Solely Stock or Securities"*

The Commissioner argued that the distribution of stock rights is not exempt from recognition of gain, since section 355(a)(1)(A)[37] permits only stock or securities to qualify for the exemption. The Tax Court felt that this technical reading of the statute failed to give effect to the basic congressional objective, and that the term "stock," as used in section 355, is sufficiently broad to encompass stock rights.[38]

The Second Circuit also rejected the Commissioner's argument, but on the ground that the stock rights were only a device to accomplish the important event, distribution of the stock.[39] The Ninth Circuit followed the view of the Regulations[40] and held that stock rights are not stock or securities within section 355(a)(1)(A) but only options to purchase stock. The court added that, since section 355(a)(1)(D)(ii) incorporates the "control" definition of section 368(c), the "stock or securities" distributed by the parent must carry voting rights, which stock rights do not carry.[41]

II

FLEXIBLE INTERPRETATION OF SECTION 355—A RATIONALE

Since the Supreme Court has granted certiorari,[42] the appropriateness of either a flexible or a strict application of section 355 should soon be resolved.[43] The Supreme Court will face a conflict between, on

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37 Quoted in note 30 *supra*.

38 Oscar E. Baan, 45 T.C. 71, 90-91 (1965), *rev'd*, 382 F.2d 485 (9th Cir. 1967), *cert. granted*, 389 U.S. 1034 (1968), *and aff'd sub nom.* Commissioner v. Gordon, 382 F.2d 499 (2d Cir. 1967), *cert. granted*, 389 U.S. 1033 (1968).

39 A sale or exchange of a stock right prior to exercise results in a tax only because it is an anticipation of gain from an exercise. It follows in this case that it is the actual distribution of the Northwest stock upon the exercise of the rights that is the relevant event and the use of the stock rights as a mere mechanism to accomplish this result should be disregarded.

Commissioner v. Gordon, 382 F.2d 499, 500 (2d Cir. 1967), *cert. granted*, 389 U.S. 1033 (1968).

40 Treas. Reg. § 1.355-1(a) (1955) states that "[f]or the purpose of section 355, stock rights or stock warrants are not included in the term 'stock and securities.'"

41 Commissioner v. Baan, 382 F.2d 485, 492 (9th Cir. 1967), *cert. granted*, 389 U.S. 1034 (1968).

42 Commissioner v. Gordon, 389 U.S. 1034 (1968); Commissioner v. Baan, 389 U.S. 1034 (1968).

43 The 1966 consolidated return regulations would prevent a corporation like Pacific from distributing stock and securities tax-free under § 355 within five years after the transfer of assets, if, like Pacific, it received in such transfer "other property" such as Northwest's demand note. *See* note 21 *supra*. If, however, the Supreme Court should uphold the flexible approach of the Second Circuit to the Pacific transaction, companies

one hand, the congressional desire to encourage business-motivated corporate separations, and, on the other hand, the aim of asserting ordinary income tax at the shareholder level, when the separation is merely a step in a plan of sale or liquidation and thus resembles a dividend.[44] Several factors support the strict construction of the Ninth Circuit. The spin-off device creates great potential for converting ordinary income into capital gain, and, therefore, clearly defined rules should govern its availability to a corporation seeking nonrecognition treatment for its shareholders. Rigidly applied tests have the further advantage of providing reliable guidelines that the Service and the taxpaying public can more easily apply. The courts would similarly benefit, since rigidly applied tests would lessen the need for case-by-case analysis of taxpayers' motives.[45]

There are more convincing reasons, however, for adopting the flexible approach of the Second Circuit in *Gordon*. The history of divisive reorganizations under the Internal Revenue Code demonstrates that the basic policy of the present section is nonrecognition of gain or loss in bona fide corporate divisions. Pre-1954 law allowed a tax-free spin-off when the spin-off was effectuated for legitimate business reasons, corporate assets remained in the corporate form, ownership of the two surviving corporations remained substantially the same, the business objective was that both corporations would continue in active business, and the transaction as a whole was not a "device" to avoid income tax. Since the subsequently-added five-year active business history test and the eighty-percent-control test were intended to implement pre-355 policies, they should not be permitted to supplant them by inflexible application in cases where the more general doctrines indicate that nonrecognition treatment is appropriate.

A. *"Devices"*

The elusive "device" concept, which has been carried over from the 1939 Code, has not been defined clearly by either Congress or the courts. The most flagrant example of a device is a spin-off followed by a sale of either corporation's stock pursuant to an agreement made

contemplating a spin-off of assets would have a convenient method of raising capital without issuing additional stock or securities.

[44] *See* Mintz, *supra* note 6.

[45] The advantage to the judiciary of rigid rules may only be illusory, however, since the "device" clause of § 355(a)(1)(B) necessitates such investigation by the court even in cases where the five-year active business history rules and the 80%-control test have been adhered to. *Cf.* Gregory v. Helvering, 293 U.S. 465 (1935), where the taxpayer met every element of the then-current statutory reorganization statute, but the conrt went on to find that the transaction conld not qualify because of lack of a valid business purpose.

before the separation. In such a case, section 355(a)(1)(B) expressly prohibits the shareholders from obtaining nonrecognition treatment. When there is no pre-transaction agreement, the statute excludes the transaction from the "automatic device" class,[46] but the Regulations provide that a subsequent sale will be *evidence* that the transaction is a device.[47] Whether mere negotiations for sale will be fatal "shall be determined from all the facts and circumstances."[48] Consideration is also given to the "nature, kind and amount of the assets of both corporations" after the spin-off, and the fact that all the assets of each have been used actively in business for five years is positive evidence that no device exists.[49] The "device" issue tends to prevent shareholders from liquidating part of their investment as an element of the divisive transaction,[50] and therefore serves to insure continuity of interest.[51]

The device clause can also result in denial of nonrecognition treatment when no sale occurs, because of the attention it focuses on the nature of each corporation's assets after the separation. Thus, when substantial unneeded liquid assets are transferred to the controlled corporation, or when a corporation with substantial liquid assets spins some assets off to a subsidiary, the device clause will likely be invoked.

The more technical requirements of section 355 give further body to the device clause. The five-year business history rule prevents a corporation from investing its excess liquid assets in a new business and then spinning it off for subsequent liquidation by the shareholders. The active-business rule prevents a corporation from separating its working assets from its investment assets and excess cash in contemplation of such a scheme. The eighty-percent-control test prevents periodic distribution of stock as a substitute for dividends[52] and contains its own

46 *See* Marne S. Wilson, 42 T.C. 914 (1964), *rev'd on other grounds* (no business purpose), 353 F.2d 184 (9th Cir. 1965), where a spin-off of credit and collection assets from a retail furniture business was not a "device," because the shareholders continued both corporations in active business and had no intention of liquidating or selling the new corporation.

47 Treas. Reg. § 1.355-2(b) (1955).

48 *Id.*

49 *Id.*

50 This is especially true if the dividend history of the distributing corporation suggests that the spin-off distribution is a belated substitute for a dividend.

51 *See* B. BITTKER & J. EUSTICE, *supra* note 26, at 477, for the view that when a spin-off is followed by a statutory merger of another corporation with either the distributing or the controlled corporation, neither the "device" clause nor the continuity-of-interest doctrine is violated, since the assets remain in corporate solution, no earnings or profits are distributed, and the original shareholders retain a continuing interest in the surviving corporation. This view would produce a result contrary to that reached in Curtis v. United States, 336 F.2d 714 (6th Cir. 1964).

52 *See* B. BITTKER & J. EUSTICE, *supra* note 26, for the view that this "purpose" is of questionable validity.

"device" clause. Thus, while the other spin-off requirements provide separate tests, all of which must be satisfied,[53] there is a good deal of interplay between them and the "device" concept. Even when the more technical requirements of section 355 are satisfied, every spin-off is potentially a "device," in that after some lapse of time the shareholders have an opportunity to sell or liquidate and enjoy corporate earnings at capital gains rates. The more general "device" clause of section 355(a)(1)(B) allows courts ultimately to determine whether the assets have remained in corporate form, with ownership remaining in the same hands. If the device test and its related concepts are resolved in favor of the shareholders, courts should apply the additional technical conditions of section 355 with a flexible attitude.

B. *Number of Distributions Required*

Another problem concerning stock distribution arises from the Commissioner's argument based on section 355(a)(1)(D)[54] that the stock of the controlled corporation must be transferred to the shareholders in a single distribution.[55] According to the Commissioner this requirement is necessary in order to determine whether the distributing corporation had the requisite eighty percent control "immediately before" the distribution. This contention, taken with the refusal of the Commissioner and the Ninth Circuit[56] to view the effect of the whole transaction rather than mere isolated distributions, is an unnecessarily rigid construction of the statute when the transaction presents no problem with business purpose, continuity, or a device.

Several cases under section 351(a), which allows nonrecognition treatment for transfers to a corporation of which the transferors have eighty percent control "immediately after" the exchange of property for stock, provide examples of the flexible approach.[57] In *James C.*

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53 *See* Commissioner v. Wilson, 353 F.2d 184, 187-88 (9th Cir. 1965), holding that the business purpose requirement cannot be satisfied merely by showing no tax-avoidance motive.

54 The section provides in part:

(D) as part of the distribution, the distributing corporation distributes—

. . . .

(ii) an amount of stock in the controlled corporation constituting control within the meaning of section 368(c), and it is established . . . that the retention by the distributing corporation . . . was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax . . . .

55 Commissioner v. Baan, 382 F.2d 485, 496 (9th Cir. 1967), *cert. granted*, 389 U.S. 1034 (1968); Commissioner v. Gordon, 382 F.2d 499, 507 (2d Cir. 1967), *cert. granted*, 389 U.S. 1033 (1968).

56 Commissioner v. Baan, 382 F.2d 485, 498 (9th Cir. 1967), *cert. granted*, 389 U.S. 1034 (1968).

57 Treas. Reg. § 1.351-1(a)(1) (1955) provides:

The phrase "immediately after the exchange" does not necessarily require simul-

Hamrick,[58] the taxpayer invented an electric device, secured a patent, and transferred the patent and borrowed capital to a corporation for the purpose of marketing the invention. In exchange, the taxpayer was to receive a portion of the company's stock and stock rights payable in installments over a period of several years. The Tax Court rejected the Commissioner's argument, similar to that made in the *Baan*[59] and *Gordon*[60] cases, that the "immediately after" requirement was not met, since the tax effect of the transaction could not be determined for a period of several years.[61] *Hamrick* seems to support the suggestion of the Second Circuit in *Gordon* that any administrative difficulties created by these prolonged transactions could be remedied by new regulations providing for advance notice to the Service and limiting the number of years in which the transactions may be completed.[62]

The Service has already done essentially this in the area of Type A, B, and C reorganizations.[63] Several conditions are imposed on delayed issuance: all the stock must be issued within five years of the initial transfer of assets or stock; there must be a valid business reason for not issuing all the stock immediately; the maximum number of shares that may be issued in the exchange must be stated in the ruling request; the right to receive stock in the future cannot be assiguable or negotiable; and the additional stock to be received must be solely that of the acquiring corporation.[64] Similar requirements applied to section 355 spin-offs would remedy the administrative difficulties cited by the Commissioner in *Baan* and *Gordon*. A representation by the distributing corporation, that conditions exist similar to those listed

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taneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure.

58 43 T.C. 21 (1964).

59 Commissioner v. Baan, 382 F.2d 485, 496 (9th Cir. 1967) *cert. granted*, 389 U.S. 1034 (1968).

60 Commissioner v. Gordon, 382 F.2d 499, 507 (2d Cir. 1967) *cert. granted*, 389 U.S. 1033 (1968).

61 43 T.C. at 34. Another case in which the phrase "immediately after" was given flexible construction is H. Grady Lester, Jr., 40 T.C. 947 (1963), which involved § 355. In that case, the parent corporation transferred to its newly-created subsidiary cash that was used to purchase operating assets from the parent. The Tax Court rejected the Commissioner's argument that temporary ownership of only cash by the subsidiary failed to meet the "active business" requirements of § 355(b)(2). 40 T.C. at 959.

62 *See* note 27 *supra*.

63 In Rev. Proc. 66-34, § 3.03, 1966-2 CUM. BULL. 1232, 1233-34, the Service announced: "where the requisite stock or property has been acquired, it is not necessary that all of the stock of the acquiring corporation . . . which is to be issued in exchange therefor, be issued immediately . . . ."

64 *Id.*

above, would obviate the need to leave the tax result open for several years, barring subsequent violation.

A court would have good reason, in addition, to apply the eighty-percent-control test to the integrated transaction, as opposed to the separate distributions, when the distributing corporation distributed *working control* of the controlled corporation in the initial distribution. This approach is somewhat related to that taken in the regulations under the 1939 Code,[65] which permitted a spin-off of the subsidiary when the parent owned enough stock to give it working control of the subsidiary.[66] In adopting this position, a court would be recognizing the fact that the eighty percent figure is a convenient but arbitrary rule of thumb, which in some situations has no relevance to whether the purpose of the transaction is tax avoidance. Thus, when a parent controls a forty- or fifty-percent-owned subsidiary and wishes to separate for a reason that would be equally applicable if the subsidiary were eighty-percent-owned (for example, to avoid antitrust litigation),[67] the parent could effect a tax-free separation under section 355(a)(1)(D)(ii) only by first acquiring enough additional stock to meet the eighty percent requirement in a tax-free stock-for-stock exchange under section 368(a)(1)(B).[68] If this is not possible, the parent is foreclosed from effecting a tax-free separation.[69]

Another disparity in the eighty percent distribution requirement is apparent from a comparison of a closely held corporation with a publicly held corporation. Rigid adherence to the requirement in all cases cannot be squared with its purpose, which presumably is to prevent the distributee shareholders from selling their newly acquired

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65 *See* Treas. Reg. 118, § 39.112(b)(11)-2(b) (1953).

66 *See* Lyons, *Corporate Separations Under the 1954 Code*, TULANE 8TH ANN. TAX INST. 574, 609 (1959), suggesting an amendment to INT. REV. CODE OF 1954, § 355 that would change the definition of control for purposes of qualifying a spin-off to conform to the "working control" definition of the 1939 Code.

67 There would be no problem if the divestiture were made necessary by an antitrust *order* rendered by a court. INT. REV. CODE OF 1954, § 1111, provides that in such case receipt of divested stock by a noncorporate shareholder will not incur dividend treatment.

68 *See* Lyons, *supra* note 66, at 608.

69 Conceivably, the separation will not be tax-free even if the distributing corporation acquires the requisite 80% stock ownership in the subsidiary. In Rev. Rul. 63-260, 1963-2 CUM. BULL. 147, the parent owned 70% of the subsidiary, and the additional 10% of subsidiary stock was acquired as a contribution to capital by the parent's sole shareholder. Tax-free treatment was not granted under § 355, because the parent was deemed not to have "control" of the subsidiary "immediately before" the distribution "except in a transitory and illusory sense." *But see* Rev. Rul. 56-117, 1956-1 CUM. BULL. 180, in which the controlled corporation was recapitalized immediately before the distribution to give the distributing corporation "control." The split-off was nevertheless accorded tax-free treatment.

shares while retaining control through their interest in the distributing corporation. Thus, when a publicly held corporation retains less than twenty percent of the subsidiary's stock, it still may have practical control, and the purpose of the statute will be undermined unless the transaction is prevented by the tax avoidance safeguard in section 355(a)(1)(D)(ii). Conversely, in the case of a closely held corporation, retention of more than twenty percent would rarely violate the purpose of the statute, since the stock of a closely held corporation is seldom marketable unless a controlling block is offered for sale. Thus, when the detached corporation is closely held, there is little need for strictly interpreting the eighty percent requirement.[70] Some of the more advanced corporation laws have been drafted with a view to solving problems peculiar to close corporations,[71] and it seems reasonable to interpret tax laws in light of the differences between public and close corporations.

C. *Use of Stock Rights*

Since the Regulations expressly proscribe the use of stock rights,[72] it is much easier to argue for a flexible application of the eighty-percent-control test and five-year business history tests than it is to equate stock rights to "stock" in a spin-off transaction. And since the Code's definition of "stock" is inadequate for present purposes,[73] one must look for analogies in the tax law. Several sections of the Code expressly include stock rights within "stock,"[74] but, as the *Hamrick* case illustrated, these sections are not exclusive, and a court would be free to interpret "stock" as including stock rights in a spin-off situation. In *Helvering v. Southwest Consolidated Corp.*,[75] a corporate taxpayer acquired the assets of

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70 *See* Note, *Divisive Reorganizations Under the Internal Revenue Code of 1954*, 67 YALE L.J. 38, 55-56 (1957).

71 *See, e.g.*, N. Y. BUS. CORP. LAW §§ 401 (permitting merely one incorporator); 616(a) (certificate of incorporation can provide for greater-than-majority of shareholders for quorum and vote on transaction of business); 620(a) (permitting shareholder voting agreements); 620(b) (certificate of incorporation can restrict authority of board of directors); 709(a) (certificate of incorporation can require greater-than-majority of directors for a quorum); 1104(a) (certificate of incorporation can provide that 50% of the shareholders can petition for dissolution) (McKinney 1963).

72 Treas, Reg. § 1.355-1(a) (1955).

73 INT. REV. CODE OF 1954, § 7701(a)(7) provides: "The term 'stock' includes shares in an association, joint-stock company, or insurance company."

74 *E.g.*, INT. REV. CODE OF 1954, §§ 305 (distributions of stock and stock rights), 307 (basis of stock and stock rights acquired in distributions), 311(a) (taxability of corporation on distribution of stock and stock rights), 312(d)(3) (effect of distributions of stock and stock rights on earnings and profits), and 317(a) (stock and stock rights of distributing corporation not included in the term "property" for purposes of the distribution).

75 315 U.S. 194 (1942).

another corporation in exchange for its voting common stock and stock warrants. The warrants carried the right to buy common stock at specified prices that increased with time until the right expired. The issue was whether stock warrants were comprehended within the language of section 112(g)(1)(B) of the 1934 Act, which provided for a tax-free reorganization when one corporation acquired the assets of another corporation in exchange "solely for all or a part of its voting stock."[76] Apparently influenced by the fact that *payment* had to be made upon exercise of the warrants, the Supreme Court held that the words "solely for all or a part of its voting stock" must be read literally and that the holder of the warrants possessed only contractual rights, not an equity interest.[77]

The opposite result was reached in *Carlberg v. United States*,[78] where, under a merger plan, each shareholder of the two predecessor corporations received in exchange for his stock a certificate for whole shares of common, a fractional share of common, and a "Certificate of Contingent Interest" in common shares that were reserved because of the contingent liabilities of one of the corporations. The plan contemplated the distribution of any reserved shares remaining after the liabilities were resolved. The court held that the certificates were not "boot" but rather true equity interests. *Southwest Consolidated* was distinguished on the ground that here no payment or other positive action was required of the certificate holders to obtain the reserved shares. The court observed that the use of certificates was dictated by a proper business exigency and that, like stock, they provided continuity of interest. The opinion also pointed out that the certificates served as a means of solving a practical problem faced by the parties: making provision for potential liabilities and at the same time effecting a statutory merger.[79]

Southwest Consolidated is strong authority for excluding Northwest's stock rights from the term "stock," because of the identical re-

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76 Revenue Act of 1934, ch. 227, § 112(g)(1)(B), 48 Stat. 705.

77 315 U.S. at 200-01. The *Southwest Consolidated* case was followed recently by the Tax Court in William H. Bateman, 40 T.C. 408 (1963). *See also* Turnbow v. Commissioner, 368 U.S. 337 (1961), where the Supreme Court strictly construed the "solely for stock" requirement of Int. Rev. Code of 1939, ch. 1, § 112(g)(1)(B), 53 Stat. 40, for qualification as a stock-for-stock reorganization. This strict approach to statutory language also was applied in Malat v. Riddell, 383 U.S. 569, 571 (1966), where the Court stated that "the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses." The Court reached this conclusion, however, only after deciding that "a literal reading of the statute is consistent with [its] legislative purpose." *Id.* at 572.

78 281 F.2d 507 (8th Cir. 1960).

79 *Id.* at 519.

quirements in both cases of payment at the time of exercise. Also, the *Carlberg* court felt the need to stress that there had been no payment. On the other hand, a liberal construction of section 355, upholding Pacific's use of stock rights, could find considerable support. Assuming, as in *Carlberg*, that there is sufficient business purpose and continuity of interest and no "device," the Supreme Court might uphold Pacific's use of stock rights by analogizing to the "practical necessity" aspect of *Carlberg*. Since Pacific's motive for the use of stock rights and cash payments was to raise needed capital for its California operations, which had been depleted by the transfer of assets to Northwest, its plan was comparable to *Carlberg*'s certificates and reserved shares as a method to raise or retain needed capital for future contingencies.[80]

Clearly, when stock rights are used in a spin-off plan as a means of distributing earnings and profits, they should be disallowed under the device provision of section 355(a)(1)(B). If the transaction is not used principally as a device, however, there is no compelling reason why the use of stock rights should not be permitted. That Pacific's stock rights were transferable should not receive undue consideration on the issue of continuity of interest, since transferability applies equally when stock is issued directly. Like a sale of stock received in a stock dividend, a sale of stock rights received as part of a section 355 transaction diminishes the shareholder's percentage of equity ownership in the original corporate assets. Moreover, the fact that some shareholders actually transferred some of their rights before the exercise deadline is of little importance, since section 355(a)(1)(D)(ii) requires only eighty percent continuity of interest, and ninety-five percent of the stock rights were exercised by the original shareholders. Nor should transferability of the stock rights be conclusive on the "device" issue, because a bailout of earnings ordinarily means that a corporation's earnings and profits have been drawn off without impairing a shareholder's interest in earning power, growth potential, or voting control.[81]

D. *Use of Cash Payments*

Undue emphasis on the presence of stock rights obscures a more crucial element of the transaction—the payment of cash consideration. The distribution of the stock rights alone, under section 305, is probably not a taxable distribution of property.[82] But the required sixteen dollar

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80 This approach was applied in James C. Hamrick, 43 T.C. 21 (1964), where stock rights were held to be "stock" for purposes of § 351. The Tax Court applied the *Carlberg* principle and upheld the use of stock rights as the solution to a problem faced by the transferor corporation at the time of the transfer.

81 *See* B. BITTKER & J. EUSTICE, *supra* note 26, at 475.

82 Although the Commissioner argued in *Gordon* and *Baan* that the distribution of

payment on exercise of the rights complicates the issue, since the ten dollar difference between subscription price and market value makes the transaction look like a disguised dividend. Nevertheless, the Commissioner's contention—that a "distribution with respect to stock" cannot occur when there is a cash consideration paid—is not unassailable. A "bargain purchase," when corporate property is transferred to shareholders pro rata at less than fair market value, is treated as a distribution with respect to stock.[83] Furthermore, the word "distributes" in section 355(a)(1)(A)(i) arguably should be interpreted as broadly as the word "distributes" in section 355(a)(1)(A)(ii), which obviously contemplates a distribution *in exchange for* other securities. When securities are exchanged in a *split-off* transaction, gain is recognized to a shareholder under section 356(d)(2)(C) only if the principal amount received exceeds the principal amount surrendered. Perhaps the Tax Court in *Baan* was analogizing to split-off treatment when it stated that there was no congressional intention to tax a shareholder who, as part of the spin-off plan, is required to contribute to the capital of the distributing corporation as a condition to receiving the stock.[84]

The Second Circuit's view that the stock rights were used as a "mechanism" for the ultimate distribution of stock has considerable merit. Pacific chose the stock rights method rather than direct distribution of stock because it needed working capital for its California operations. Since a distributing corporation is permitted to transfer an amount of liquid working capital to the controlled corporation based on the reasonable and foreseeable needs of the controlled corporation, there is no reason to prohibit the parent-distributing corporation from raising sufficient additional capital to meet its own reasonable needs without issuing further stock or debt securities. This view is underscored by the original purpose of section 355 and its predecessors—to facilitate corporate separations that are motivated by legitimate nontax business reasons by removing the hindrance of prohibitive taxation at the shareholder level. This underlying policy should apply equally at the corporate level. The tax law governing corporate separations should not inhibit bona fide spin-offs by requiring a separate issuance of stock or debt securities by a parent-distributing corporation that finds itself short of operating capital.

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the rights was a taxable event, the ruling letter issued prior to the spin-off stated that the distribution of the rights would not result in tax to the shareholders. *See* Palmer v. Commissioner, 302 U.S. 63, 71 (1937).

[83] Treas. Reg. § 1.301-1(j) (1955), *as amended*, T.D. 6752, 1964-2 CUM. BULL. 84.

[84] Oscar E. Baan, 45 T.C. 71, 90 (1965), *rev'd*, 382 F.2d 485 (9th Cir. 1967), *cert. granted*, 389 U.S. 1034 (1968), *and aff'd sub nom.* Commissioner v. Gordon, 382 F.2d 499 (2d Cir. 1967), *cert. granted*, 389 U.S. 1033 (1968).

Although the new consolidated return regulations rule out the future applicability of the specific facts of *Baan* and *Gordon*, the remainder of the transaction (stock rights, cash payment, periodic distributions) may prove to be an important capital-raising device that would serve the legitimate business needs of the taxpaying public. Whether the Supreme Court or other courts will sanction it depends on their willingness to adopt a flexible approach to section 355 rather than to apply mechanically the somewhat artificial and arbitrary tests in the statute.

CONCLUSION

With the exception of cases decided by the Ninth Circuit,[85] courts have tended to adopt a flexible approach to section 355 and to read its terms broadly when the attempted spin-off transaction conforms to the purpose of the section, *i.e.*, has legitimate business purposes, continuity of interest, and no tax-avoidance "device." *Parshelsky's Estate v. Commissioner*[86] held that a "business purpose" of an individual shareholder could support tax-free treatment as well as a corporate purpose. *Coady v. Commissioner*[87] held that the fact that section 355 requires each corporation, after the distribution, to engage in an active business with a five-year history, does not demand that each such business must be conducted on an individual basis throughout the prior five-year period. The Fifth Circuit agreed with *Coady* in *United States v. Marett*,[88] reasoning that the Commissioner's pre-distribution two-business rule was "an attempt to add a restriction to the statute which is not there."[89] In *Lockwood's Estate v. Commissioner*,[90] the Eighth Circuit held that when similar independent activities are commenced at a new location without terminating activities at the old location, no new business has been commenced for purposes of the five-year business history rules.[91] In *Gabriel Fabrication Co.*,[92] the Tax Court held that section 355 does not

85 *See*, in addition to the *Baan* case, Commissioner v. Wilson, 353 F.2d 184 (9th Cir. 1965).

86 303 F.2d 14 (2d Cir. 1962).

87 33 T.C. 771 (1960), *aff'd*, 289 F.2d 490 (6th Cir. 1961).

88 325 F.2d 28 (5th Cir. 1963).

89 *Id.* at 30. *But see* Lockwood's Estate v. Commissioner, 350 F.2d 712 (8th Cir. 1965), and Patricia W. Burke, 42 T.C. 1021 (1964), in which the Commissioner unsuccessfully argued that branch stores which had been separated from the main stores constituted separate businesses and therefore lacked the requisite five-year business history.

90 350 F.2d 712 (8th Cir. 1965).

91 *See also* Patricia W. Burke, 42 T.C. 1021 (1964).

92 42 T.C. 545 (1964), *acquiesced in*, 1965-1 CUM. BULL. 4.

require that the business conducted during the five-year period be conducted by either the distributing or the controlled corporation, provided its acquisition was tax-free.

In the *Baan* and *Gordon* cases, the Supreme Court should similarly adopt a flexible approach to section 355. Although rigid application of the statute would insure future disqualification of tax-avoidance manipulations, it would fail in the other, and equally important, purpose of section 355—facilitating changes in corporate form when such changes are motivated by business reasons other than tax avoidance.

Robert G. Parker