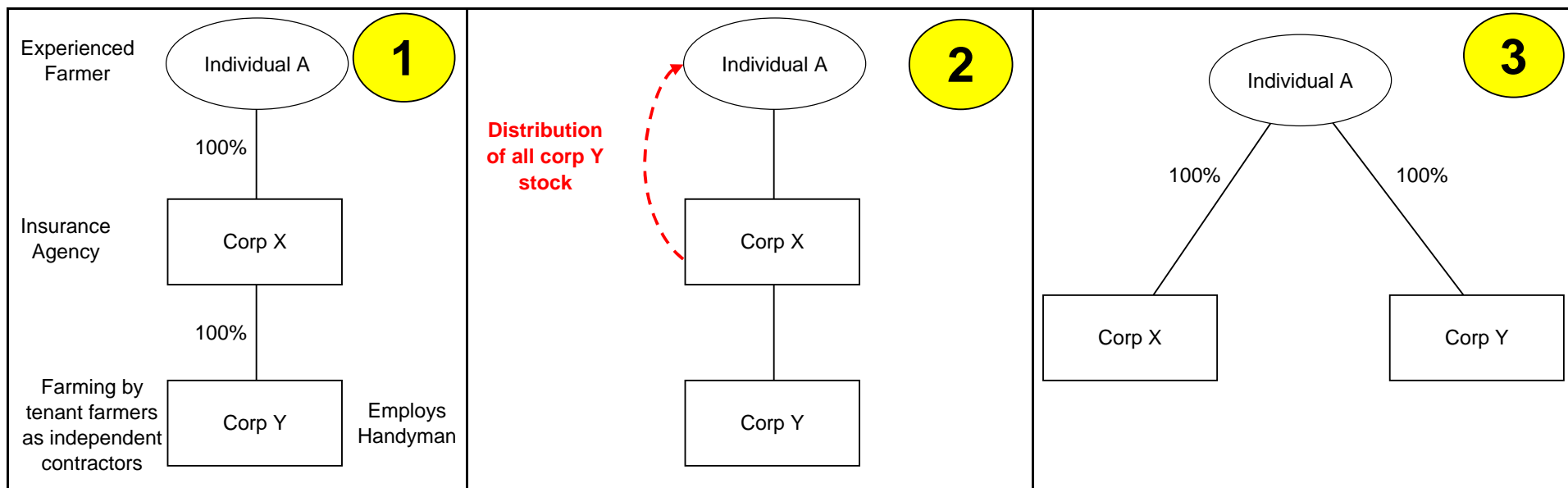


**Active Trade or Business
With Independent Contractor
Tenant Farmers**

Initial Structure

Spin-Off

Ending Point



A is the president and only shareholder of X corporation which has been engaged in the insurance agency business for the previous five years X has owned all the outstanding capital stock 100% corporation since Y was incorporated more than five years ago. Since its incorporation Y has been engaged in a farm operation. X proposes to distribute all the Y stock to A in a transaction intended to meet the requirements of section 355(a) which provides for the nonrecognition of gain or loss to a shareholder upon the distribution of the stock of a controlled corporation where the requirements of section 355(a) are satisfied.

The planting, raising, and harvesting of crops and the breeding and raising of livestock in Y's farm operation are done by tenant farmers, acting as independent contractors. The tenant farmers are compensated by a share of the proceeds from the sale of all crops and livestock resulting from the farm operation. Y employs B as a general handy-man to maintain the farm property and equipment. Y employs A to participate in the farm operation.

A is an experienced farmer. Each year A, on behalf of Y, enters into agreements with approximately six tenant farmers and allots to each of them responsibility for a portion of the farm operation. A prefers to contract with tenant farmers who have experience with farm machinery and livestock. Y supplies all equipment and arranges for all financing necessary for Y's operation. With regard to the farm equipment, A engages a local mechanic for the maintenance and repair thereof that is not performed by B or the tenant farmers.

A devotes significant time and effort to the farm business of Y. He studies Federal price support and acreage reserve programs, plans all rotation, planting, and harvesting of crops, and purchases and plans the breeding of livestock. He hires seasonal workers and purchases farming equipment, is responsible for handling sales of all crops and livestock, and is responsible for accounting to the tenant farmers for their shares of the proceeds of the sales. After the distribution, Y will continue the operation of its business in the manner described above.

Section 355(b) requires, in part, that both the distributing and controlled corporations be engaged, immediately after the distribution, in the active conduct of a trade or business that has been actively conducted throughout the five-year period ending on the date of distribution. Reg. 1.355-1(c) in defining "active business," provides, in part, that a trade or business consists of a specific existing group of activities being carried on for the purpose of earning income or profit from only such group of activities, and the activities included in such group must include every operation which forms a part of, or a step in, the process of earning income or profit from such group. Such group of activities ordinarily must include the collection of income and the payment of expenses.

Section 355, by requiring that a trade or business be actively conducted, connotes substantial management and operational activities directly carried on by the corporation itself, and not the activities of others outside the corporation, including independent contractors. However, the fact that a portion of a corporation's business activities is performed by independent contractors will not preclude the corporation from being engaged in the active conduct of a trade or business if the corporation itself directly performs active and substantial management and operational functions.

In the instant case Y's farm activities include its direct performance of substantial management and operational functions, apart from those activities performed by the tenant farmers acting as independent contractors. Accordingly, under the facts Y satisfies the active business requirements of section 355(b).

See also Rev. Rul. 73-237, which holds that a general construction contractor's direct performance of substantial management and operational activities, apart from those activities performed by subcontractors acting as independent contractors, satisfies the active conduct of a trade or business requirements in section 355. Compare Rev. Rul. 73-236 which holds that a trust conducting its real estate leasing business activities through independent contractors in compliance with the real estate investment trust provisions of section 856 does not and cannot satisfy the active conduct of a trade or business requirements in section 355.

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