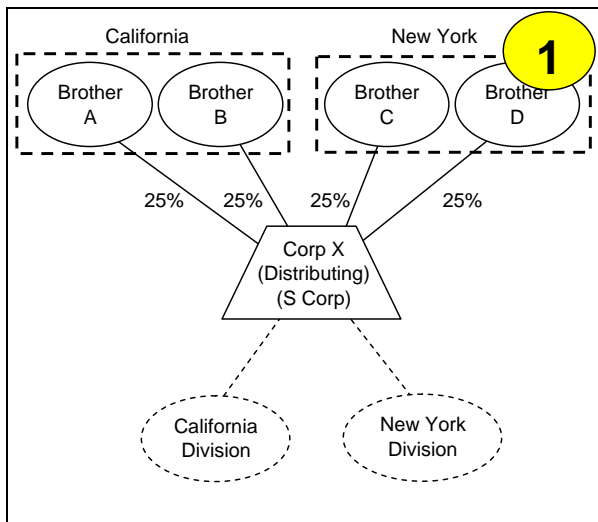
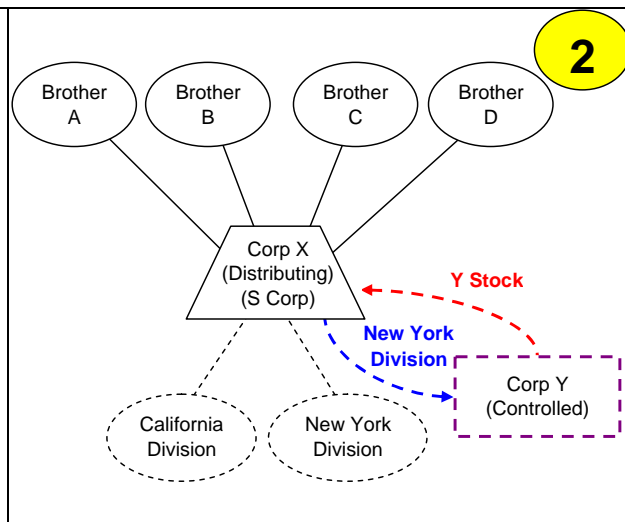


**Momentary Ownership of Corporation
Did Not Terminate S Election**

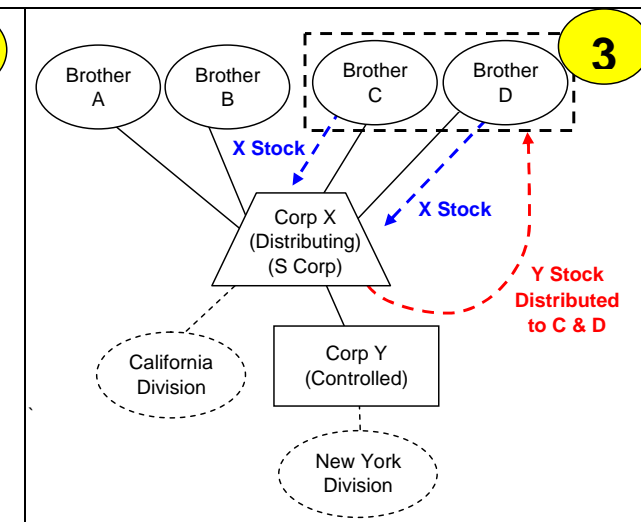
Initial Structure



Drop Down



Split Off



X corporation, a small business corporation, elected to be treated as an S Corporation. X Corporation is a manufacturer of heavy construction equipment. It has been engaged in this business in California since 1965. In 1970 X corporation opened a division in New York. Four brothers, A, B, C, and D, own all the stock of X corporation in equal amounts. A and B operate the California division. C and D operate the New York division. In recent years the conduct of the business has been hindered by basic differences between the brothers. A and B are interested in expanding and diversifying the business. C and D want to receive a guaranteed income in the form of large cash dividends.

Since the brothers' objectives were in conflict, a plan of reorganization was adopted pursuant to which X created Y corporation and transferred the assets, subject to all the liabilities, of the New York division to Y in exchange for all of Y's stock; and immediately thereafter C and D exchanged all their stock in X for all of Y's stock in a transaction qualifying under section 355. The transfer of assets by X to Y qualified as a reorganization under section 368(a)(1)(D).

The Code provides that a small business corporation means a domestic corporation which is not a member of an affiliated group as defined in section 1504. Section 368(a)(1)(D) of the Code provides that the term "reorganization" means a transfer by a corporation of all or part of its assets to another corporation if immediately after the transfer the transferor or one or more of its shareholders, or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356. The ruling held that since X never contemplated more than momentary control of Y, the affiliation will not be considered as terminating the small business corporation election of X under Subchapter S. **Note that in 1997, section 1361(b)(2) was amended to eliminate the affiliated group prohibition.**

Ending Point

