Some Observations on Subchapter C of H. R. 8300 Revenue Code of 1954

William H. Friedman
I am going to talk about the provisions dealing with distributions by corporations beginning with Section 301. Section 301 states the general rule regarding taxability of a dividend distribution by a corporation. In the case of an individual shareholder, he is taxed on the cash and on the fair market value of property received as a dividend. If property received is subject to a liability, only the difference is taxed. In other words, if an individual receives property worth $1,000 and subject to a liability of $700, he takes only $300 into income.

However, in the case of a corporation shareholder, there is a new rule as to dividends in property. The corporation takes this dividend into account only to the extent of the basis of the distributing corporation. Suppose the distributing corporation has property which cost $500, and is now worth $1,000 and distributes this property to a corporation stockholder. Under the present law, the corporation stockholder would take into account 15% of the first $500 and all of the second $500, and so would pay tax on $575; and its new basis would be $1,000. Under the new law, the corporation recipient will take into account only $75, and its basis will be $500; but if the property received is subject to a debt, that is applied against the basis to the distributing corporation to determine taxability to the recipient corporation. If the asset costing the distributing corporation $500 and worth $1,000 is subject to a debt of $700, then the recipient corporation has no tax whatever to pay on this distribution; however, the distributing corporation must report a gain of $200, that being the excess of the debt against the basis to it, and the basis to the recipient corporation is $700. This change as to dividends in kind paid to corporations is part of the new policy contained in H.R. Section 300 of postponing tax on unrealized gains.

Section 302 makes a major change by codifying the rules applicable to present Section 115(g). Section 115(g) is the section which under certain circumstances makes the redemption of stock taxable as a dividend, depending on the factual circumstances, as distinguished from capital gain. There has been a lot of litigation under Section 115(g), with...
inconsistent results in the decided cases, and uncertainty as to its meaning. Under Section 302, redemptions will generally result in dividend income, except that Section 302 proposes to provide certainty in six classes of cases in which capital gain will result:

First, is the case in which the corporation must pay the new 85% transfer tax. Where there was a preferred stock dividend followed by a sale of the preferred stock, the Chamberlin case recently held that the sellers of the preferred stock got a capital gain. The Government argued that this was ordinary income. The new law meets this situation by providing that if a corporation redeems preferred stock within ten years after its issuance, there may in certain circumstances be a new transfer tax of 85% imposed on the amount of money and property paid out by the corporation in redemption of the preferred stock. This is covered by Section 309 to which I will refer later. Section 302 says that in this class of case, that is, where the corporation has to pay the new 85% transfer tax at the time of redemption of the preferred stock, the recipient will get a capital gain and the distribution will not be ordinary income to him. Under this rule, if the purchaser of the preferred stock in the Chamberlin case has his preferred stock redeemed by the corporation, he will have a capital gain, but the corporation will have to pay the new 85% transfer tax.

The second situation in which capital gain is provided by Section 302 for redemptions of stock is in the case of redemptions in partial or complete liquidation. Redemptions on the complete liquidation of a corporation are now taxed as capital gains; Section 302 continues this rule; Section 336 of the new law codifies the definition of distributions in complete liquidation and includes cases where all the distributions are made within not more than a three-year period. Section 336 also provides for an extension of time of the three-year period with Government consent.

Section 336 also for the first time defines partial liquidation and limits it to the case of a liquidation by a corporation of one of two or more businesses. This is true only if the two or more businesses have been separately conducted for at least five years and have had separate sets of books for at least five years and if both have been operating companies as distinguished from personal holding companies. If one of these businesses is liquidated and the proceeds distributed in redemption of stock, this is capital gain. This narrow definition is new in the statute but codifies some of the existing case law. This exception to Section 302 is not applicable if inventory is distributed, this being one of the new provisions designed to replace existing Section 117(m) dealing with collapsible corporations.

A third class of cases covered by Section 302 is the complete redemption of all the preferred and common stock of a particular stockholder provided the stockholder gives up all future interest in the corpo-
tion as an officer, director or employee. The section operates even though
the stockholder continues to be a creditor. Parenthetically, the new law
does not talk of preferred stock and common stock; it talks of participating
stock which is, generally speaking, like common stock, and of non-participat-
ing stock, which is, generally speaking, like preferred stock. Now this new
section will not apply if the stockholder re-acquires any interest in the
corporation within ten years after the redemption; if he does, the statute
of limitations is opened up and he must pay ordinary income tax on the
distribution which was previously taxed as capital gain. Also, the section
does not apply if the stockholder received a gift of stock of this corporation,
or made a gift of this stock of this corporation, within ten years preceding
the redemption. But this exception is in turn subject to another exception,
which is, that if the stockholder received the gift or made the gift within
the ten years preceding the redemption for purposes other than tax
avoidance, he may still get a capital gain on the redemption. This
particular part of Section 302 does not apply if the property distributed
in redemption of stock consists of inventory, another reference to the
collapsible corporation problem.

A fourth class of cases in which a redemption of stock will result in
capital gain is where the redemption effects a change in the proportionate
ownership of the corporation, reducing the percentage of the stockholder
in the participating stock of the corporation to less than 80% of what
he previously had. For example, if he previously had 25% of the
participating stock of the corporation, and after the redemption he has
10% of the participating stock of the corporation, as to him the redemption
results in capital gain, because he now has less than 80% of the percentage
of participating stock which he previously had. But in applying this
section, you take into account the stock owned by the stockholder's
family, and by corporations, trusts, estates, and partnerships in which he
has an interest. This is called the rule of attributed ownership under
Section 311 which I will discuss later. This particular part of Section
302 does not apply to distributions of inventory and its does not apply
to redemptions of non-participating stock unless coupled with a qualifying
redemption of participating stock, that is, one which changes the stock-
holder's interest in the participating stock by more than 20%.

A fifth class of cases in which redemptions result in capital gain is
the case of a redemption from a stockholder owning less than 1% of
the participating stock. In this case also the rule of attribution of ownership
applies, and to determine whether the stockholder owns more or less
than 1% you take into account the stock owned by his family, cor-
porations, etc.

The sixth class of cases is the redemption of stock from an estate
where the amount of the redemption does not exceed the estate and
inheritance taxes. This presently is Section 115(g)(3), but the new law
broadens this provision to take into account funeral and administration expenses as well as death duties. Also, the new section applies if the decedent owns stock of the distributing corporation constituting either 35% of his gross estate or 50% of his net estate, whereas under present law it qualifies only if such stock is 35% of the gross estate. There is a new provision by which ownership of stock of two or more corporations can satisfy the 35% of gross and 50% of net tests, if the decedent owned more than 75% of the stock of each such corporation. For example, the decedent has an estate of $500,000, he owns stock in Corporation A worth $150,000, and he owns stock in Corporation B worth $150,000. In each case he owns more than 75% of the stock of A and of B. This situation would not have qualified under the existing law, but under the new law, you lump the two stock ownerships and since together they equal $300,000, this situation satisfies the test, and redemptions of stock by Corporations A and/or B will not be taxed as a dividend if such redemptions do not exceed the total of estate and inheritance taxes, funeral and administration expenses. Such redemptions might result in capital gain or there might be no tax at all.

The provision with respect to redemption after death applies to both participating and non-participating stock, and such redemption does not result in the payment of the new 85% transfer tax provided in Section 309. In other words if a man dies owning the requisite percentage of stock to satisfy the 35% of gross estate or 50% of net estate requirement, redemptions of such stock not in excess of taxes and administration expenses will not result in a dividend and will not result in any transfer tax on the corporation, and this is true whether the decedent owned participating stock, non-participating stock or both.

Section 304 provides a new rule in the case of the sale of stock of one corporation to another corporation in so-called Class B affiliations. Suppose Mr. A owns a controlling interest in Corporation B and a controlling interest in Corporation C. Controlling interest for this purpose is a 50% interest as later defined. Under present law, if he sells stock of C to B, he gets capital gain. Under the new section, such sale will ordinarily result in ordinary income to A, depending on the earnings and profits of Corporation B, unless after the sale, he has lost enough of the participating stock of C so that his percentage of ownership of participating stock of C is reduced by more than 20%. In making the determination as to whether A controls Corporations B and C, you take into account under the attribution test, the stock owned by his family, corporations, estates, etc. which he controls, and in determining the extent to which he has lost participating stock in C, you take into account his proportionate interest in C through his ownership of the stock of Corporation B which has now acquired the stock of Corporation C. All this is new law. Section 304 also includes that portion of Section 115 which over-
ruled the *Wanamaker* case (which dealt with a sale of the stock of a parent to its subsidiary corporation), and Section 304 also newly covers the case where A sells the subsidiary stock to the parent; this is the reverse of the *Wanamaker* situation, not now covered by Section 115(g).

Section 304 does not apply to public corporations, but only to closely held corporations. In other words, in the case of publicly held corporations, it is still possible to sell the stock of one corporation to a related corporation at capital gain rates. It seems to me this would be true even if Section 304 did not expressly mention publicly held companies, since Section 304 applies only in the case where the stockholder has a controlling interest; such controlling interest is defined as ownership of at least 50% of the voting power or at least 50% of the value of all outstanding stock. The definition of a public corporation contained in Section 359 of the new law provides that a corporation is publicly held unless ten or fewer shareholders own more than 50% of the total voting power or of the total value of the stock of a corporation. Accordingly, it would seem that the definitions of a publicly held corporation and of Section 304 are mutually exclusive.

Section 305 lays down a broad general rule that no income and no gain or loss is realized by a stockholder upon the receipt by him of stock of the same corporation or of stock rights. This applies to the receipt both of participating and non-participating stock. It also applies whether or not the stockholder turns in any of his old stock. In other words, in one single section, the rule is laid down for issuance of stock dividends, stock rights, and exchanges of stock of the same corporation.

The new section changes the old law in that, in connection with issuance of stock dividends and stock rights, it is no longer necessary to consider whether there is any change in the proportionate interest held by the stockholder in the corporation. This proportionate interest test has given rise to a great deal of litigation for 20 years in cases where preferred was distributed on common, or preferred on preferred, or common on preferred, or non-voting common on voting common, and in cases where stock was distributed to less than all the stockholders.

The general rule under the new bill is that if you get stock of the same corporation, it is a tax-free stock dividend.

It is also the general rule that if you exchange stock for stock of the same corporation, it is tax-free. It is no longer necessary to consider whether the transaction qualifies as a tax-free recapitalization or tax-free reorganization; the business purpose test is to this extent abolished. If you begin with stock and end up with stock of the same corporation, the exchange is tax-free.

Under Sections 352 and 353, which we will discuss later, Section 305 also becomes the section under which exchanges of stock of one corporation for stock of another corporation, and receipt of stock of another corporation
in connection with mergers, consolidations and other corporate readjustments are tax-free.

The section also provides that an exchange of securities for stock of the same corporation will always be tax-free. Securities will be defined later. Here the rule as to securities is absolute without any requirement of qualifying as a recapitalization or reorganization, although generally under the new bill the receipt of securities is taxable.

However, there are three exceptions to the broad rule of Section 305:

1. If the distribution of stock or stock rights is made in payment of dividends on non-participating stock, the fair market value of the stock or rights received is taxed as a dividend.

2. If the stockholder has an option to take either stock or property, then he will be taxed as a dividend to the extent of the fair market value of the property which he could take.

3. If the distribution is of non-participating stock by a foreign corporation, the distribution is taxable unless the Treasury is satisfied that the transaction is not part of a tax avoidance plan. This provision was deemed necessary to prevent avoidance of the new transfer tax under Section 309.

Section 306 provides the rules applicable to the receipt of securities and other property in connection with exchange of stock. It applies whether the exchange is of stock in the same corporation, or for stock in other corporations in connection with mergers and consolidations and other corporate readjustments. The broad general rule is that if securities or other property are distributed to a shareholder whose proportionate interest in participating stock is not materially changed, the receipt of securities and property is taxed as a dividend. We have already seen that the test as to whether the proportion of participating stock is materially changed depends upon whether the interest of the stockholder in the participating stock is reduced by at least 20%. If the interest of the stockholder in participating stock is not reduced by at least 20% either in the distributing corporation, or in the new corporation whose stock he receives in exchange for his old stock, then the receipt of securities or other property is taxed as a dividend. This makes two major changes from the old law. Under the old law, securities could in proper cases be received tax-free. This is generally no longer so except where securities are exchanged for securities as I will explain shortly. The general rule now is that the receipt of securities is taxed. The other major change in this field of the Tax Law is that no comparison is made as between the value of the old holdings and the value of the new holdings. Under present law such a comparison is made and the amount of the dividend is limited to the gain on the transaction. Under the new law this will not be done. The entire amount of securities and other property will be taxed as a dividend. If securities are surrendered in the transaction, then only the
excess of face value of securities received over face value of securities surrendered is treated as boot.

But if the interest of the stockholder is materially changed, that is, if his interest in the participating stock of the old corporation (or with respect to the new corporation) is reduced by more than 20% then you do make a determination as to whether there is a gain on the transaction, and if there is a gain the receipt of the securities and other property is taxed as a capital transaction to the extent of the gain. No loss is recognized on such a transaction.

The rules that have just been discussed replace the old boot rules in reorganizations under old Section 112(c), and codify the rules laid down by the Supreme Court in the Adams and Bazeley cases and similar cases. So far I have discussed cases where the taxpayer was a holder of stock before the transaction. The rules of Section 311 are applied to determine whether the taxpayer owned stock.

Section 306 then distinguishes the case where the taxpayer held securities but no stock before the transaction.

In the case of security holders who hold no stock, the rule of the Neustadt case is codified and extended by providing that there is no gain or loss on the exchange of securities regardless of face amounts, interest rates or maturity dates. But if the transaction involves receipt of money or other property in addition to securities then there are tax consequences depending on whether the principal amount of securities received is more or less than the principal amount of securities surrendered. If the principal amount of securities received is equal to or more than that surrendered, then any receipt of money or property goes into ordinary income and is not capital gain. If the principal amount of securities received is less than that surrendered, then the transaction results in capital gain or capital loss.

Section 307 codifies existing law with regard to the basis of stock, stock rights, securities or property received as a stock dividend, or in connection with an exchange of stock or securities or in a corporate readjustment. The general rule is that the basis of the old holding is apportioned among the stock, securities or property acquired in accordance with rules to be determined by the Treasury, and such apportioned basis shall be decreased by the amount of any money received in the transaction and increased in the amount of any gain recognized in the transaction. However, one important change is made from existing law as regards the receipt of stock rights. If such stock rights are worth less than 15% of the fair market value of the stock on which distributed, then no allocation is required, and the basis of the stock rights is zero. However, the taxpayer may elect to allocate the basis if he chooses, and of course if the value of the stock rights is more than 15%, then he must allocate.

As regards receipt of stock, Section 307 applies only to stock of the
distributing corporation. Stock of other corporations is here treated as property and not as stock, although by the application of Sections 352 and 353 dealing with mergers, consolidations and other corporate readjustments, and provision is made that in cases falling under those sections the stock of other corporations shall be treated the same as stock of the distributing corporation, this would affect the allocation under Section 307. In the case of stock of other corporations received as a dividend, allocation of basis would ordinarily not be required.

Section 308 codifies the rule of the General Utilities and Operating case that a corporation realizes no gain on the distribution of assets. However, where such distribution is as a dividend, Section 308 changes existing law in two respects:

If lifo inventory is distributed as a dividend, then gain is recognized to the distributing corporation to the extent of the difference between the lifo inventory value and the value at which such inventory would otherwise have been taken into account, such as the lower of cost or market, or retail method of inventorying.

The second change is that if an asset is distributed as a dividend subject to a liability which exceeds the basis of the asset to the distributing corporation, the excess of the liability over the basis is taxed to the distributing corporation.

In the case of distributions in partial and complete liquidation, these two new rules as to distribution of lifo inventory and as to distribution of assets subject to debt do not apply.

Section 309 imposes the new 85% transfer tax on distributions by a corporation in redemption of non-participating stock. This is new and its main purpose is to eliminate the rule of the Chamberlin case. In that case, recently decided by the Sixth Circuit, and in which the Supreme Court denied certiorari on March 8th, it was held that common stockholders who receive a preferred stock dividend and immediately sell it get a capital gain without regard to the fact that the purchaser of the preferred stock may turn the preferred stock into the corporation for redemption without the purchaser having to pay any tax. Section 309 says that if non-participating stock is redeemed within ten years after issuance, the corporation pays a tax of 85% on the money and property it pays out in redemption for the stock. There are six exceptions to this new transfer tax:

1. If the transfer is part of a complete or partial liquidation.
2. If the transfer is one in which the redemption of non-participating stock is from the original holder thereof, and at the same time the participating stock on which the non-participating stock was issued is also redeemed.
3. If the non-participating stock has been issued for property or securities and if the transfer in redemption of the non-participating stock
is of property and securities which is not more than 105% of the value of the property and securities originally received for the non-participating stock. If the redemption price is more than 105% of such value, then the 85% transfer tax applies only on the excess.

4. Redemptions which are taxed as dividends do not result in the 85% tax.

5. Redemptions under Section 303 dealing with redemptions to pay death taxes, administration expenses, etc., are not subject to the new transfer act.

6. A redemption in exchange for stock of a different corporation in connection with a merger or consolidation or other corporate readjustment also constitutes an exempt transaction. In a case like this the new stock takes the place of the old non-participating stock and the redemption of the new stock may be subject to the 85% transfer tax, and the ten-year period begins from the date of issuance of the old non-participating stock.

In cases where the non-participating stock was issued before January 1, 1954, the ten-year period runs from January 1, 1954. This provision may have the extraordinary results of imposing a heavy tax on a corporation required by its charter to redeem preferred stock issued many years in the past.

Section 310 contains rules, mostly new in the Code, for adjustments to earnings and profits. Many of these rules codify existing case law and rulings. However, there are some new rules. For example, it has never been clearly established by existing case law whether a distribution by a corporation of assets is to result in an adjustment to earnings and profits in the amount of the basis to the distributing corporation or in the amount of the fair market value of the distribution. The new law makes the reduction in the amount of the basis. Another new rule is that if the property distributed is subject to a debt, then the reduction in earnings and profits is reduced to the extent of such indebtedness but not more than the basis of the distributed property.

A few examples will illustrate these rules. If the corporation distributes property which cost $100.00 and is now worth $150.00, and it has earnings and profits of $120.00, then the reduction in earnings and profits is $100.00; an individual stockholder picks up $120.00 as dividend income and $30.00 as reduction of base; and a corporation stockholder picks up $100.00 of dividend.

If this asset were subject to a liability of $120.00 there would be no reduction in the earnings and profits of the distributing corporation; the distributing corporation would report income of $20.00; and individual stockholder would report a dividend of $30.00; a corporation stockholder would report no dividend.

A new rule is provided with respect to the distribution of inventory assets which have appreciated in value. In such case the earnings and
profits of the distributing corporation get two adjustments, one up to the extent of the gain, and another down to the extent of the fair market value. The result is that the reduction in earnings and profits is in the amount of the cost of the inventory assets, but the earnings and profits have been increased enough to make sure that the stockholders will have to report the full value of the inventory as a dividend. This is part of the new approach to the collapsible corporation problem.

A new rule is provided for the adjustment to earnings and profits in cases of partial liquidations, redemptions of stock, and corporate separations which would include split-ups, split-offs, and spin-offs. As a general rule, it may be said that the adjustment to earnings and profits will be in the same ratio as the ratio of the basis of distributed assets is to the basis of retained assets. In applying this rule, the basis of the total assets of the corporation before distribution is reduced by liabilities, and the basis of the assets distributed is reduced by liabilities to which such assets are subject. Where the distribution is in redemption of non-participating stock in a transaction in which capital gain is realized by the distributee, then the earnings and profits of the distributing corporation are decreased by the excess of the basis of the distributed assets over the par value of the non-participating stock. In other words the redemption is treated as coming out of capital to the extent of the par value of the redeemed stock.

No provision is made with respect to the earnings and profits of a distributee corporation in a corporate separation. On this point the Committee report says only that the total of earnings and profits after the transaction of distributing and recipient corporations should not exceed the total earnings and profits before the separation.

Section 311 contains the rules for attribution of ownership to a stockholder of stock owned by members of his family, by corporations, trusts, estates and partnerships in which he has an interest. In the case of a partnership, only the partner’s proportionate interest of the partnership stock is attributed to him. In the case of a corporation, all the corporation’s stock is attributed to the stockholder who owns more than 50% in value of the outstanding stock. In the case of a chain of corporations where there is more than 50% control down the line, the individual holding more than 50% of the top corporation is charged with ownership of all the stock owned by the bottom corporation. The attribution of ownership provisions are new in the law as regards redemptions of stock, distributions of property, and corporate readjustments. Similar provisions in the present code are in relation to personal holding corporations and disallowed losses. It is stated that one purpose of the inclusion of the attribution of ownership provisions is to eliminate the existing uncertainty with regard to the application of Section 115(g). It will be recalled that the Treasury had proposed a regulation under Section 115(g), the effect of which would
be that even if all the stock of a particular shareholder were redeemed, the result might be divided income and not capital gain if members of his family still owned stock. There was a good deal of opposition to this proposal and it was ultimately withdrawn, but despite this withdrawal the Treasury has in some cases continued to apply the spirit of the proposed regulation. The new law eliminates this particular uncertainty by specifying the applicable rules.

The attribution of ownership rules apply to trusts and estates, and a beneficiary having an interest of at least 50% in a trust or estate or in the income thereof is considered as owning all of the stock owned by the estate or trust. So also if an individual is taxed on the income of a trust under the Clifford and similar rules, he will be treated as the owner of stock owned by the trust.

Section 312 contains the definitions applicable to Subchapter C. The definition of “dividends” is similar to that in existing law, including distributions by personal holding companies even though not out of earnings and profits.

“Participating stock” is defined in terms which generally encompass voting and non-voting common stock but it would not include common stock if it is preferred in any respect to other stock as to distribution of earnings or distribution of assets in liquidation.

The term “security” is defined as an instrument representing an unconditional obligation to pay a stated sum of money, such obligation being of the distributing corporation. The term “security” does not apply (1) to open account indebtedness, (2) to obligations held by persons owning 25% or more of the participating stock and subordinated to the claims of trade creditors generally and (3) to obligations where the amount of interest is dependent on earnings of the corporation. Instruments which do not qualify as securities would be treated as non-participating stock.

Short term notes and demand notes which are not presently classed as securities under existing law would be treated as securities under the new law.

The term “non-participating stock” is defined as an instrument issued by a corporation known generally as corporate stock or corporate security which is not participating stock and which is not a security. This would include preferred stock and some obligations.

The term “redemption of stock” is defined to cover cases where the stock which is purchased is not cancelled or retired and is held as treasury stock; and a reduction in par value of stock accompanied by a distribution of property is treated as a redemption.

The term “property” is defined to include money, securities representing debt of other corporations than the distributing corporation, and stock of corporations other than the distributing corporation. However, under Sections 352 and 353, dealing with mergers and consolidations and
corporate readjustments, stock of a corporation other than stock of the
distributing corporation may be treated as stock of the distributing
corporation (and not as property) for purposes of Sections 301 to 312
inclusive.

Part II of Subchapter C deals with corporate liquidations. Here a
brand new rule is adopted. Under existing law in the case of most
corporate liquidations, gain or loss is recognized in the amount of the
difference between the fair market value of assets received and the
cost basis of the stock surrendered. Under the new bill (Section 331),
loss will generally be recognized, but gain will be postponed except in
those cases where the assets distributed have a higher basis to the distributing
corporation than the basis of the surrendered stock. The new bill has
some similarity to old Section 112(b)(7), but is simpler in approach and
there is no tax on surplus. A few examples will explain the new
provisions:

Basis to the distributing corporation $100.00, fair market value $150.00,
basis of the stock to the shareholder $125.00. In this case there is no
gain or loss to the stockholder, and his basis for the assets received is
$125.00.

Basis to the distributing corporation $100.00, fair market value $150.00
basis of the stock to the recipient is $100.00. In this case gain of $25.00
is recognized and the basis of the assets to the recipient stockholders is
$125.00.

Basis to the distributing corporation $150.00, fair market value $100.00,
and basis to the recipient stockholder of his stock is $125.00. In this case
there is a recognized loss of $25.00, and the new basis is $100.00.

These rules apply both to partial and to complete liquidation as later
defined.

Where the asset distributed by the liquidating corporation is stock
of an acquiring corporation in a tax-free corporate acquisition as later
defined, then no gain or loss is recognized to the recipient stockholder
in the transaction. Such a case falls within Section 305 dealing with tax-free
receipt of stock and is treated as a tax-free exchange as under the
reorganization sections of the old Code.

Section 331 also alters the existing law as regards liquidation of
subsidiaries under old Section 112(b)(6). In such cases under present
law no gain or loss is recognized as regards distributions on the stock of
the subsidiary to the parent. Under Section 331 loss on such a liquidation
will be recognized in most cases. Gain will not be recognized, and in
some cases the parent's basis for the stock will become the basis for the
assets acquired from the subsidiary contrary to present law.

Another major change in the operation of Section 112(b)(6) is that
obligations of the subsidiary held by the parent are treated as stock.
Accordingly, it will no longer be true as it is under present law that in
the case of the liquidation of a subsidiary, distributed assets are applied
first against the debt of the subsidiary held by the parent. Under present
law if such debt exceeds the basis of the distributed assets, and there has
been an appreciation in the value of such assets, the subsidiary realizes
gain. Under the new law, the subsidiary will not realize any gain. The
basis to the parent of the securities of the subsidiary is added to the
basis to the parent of the stock of the subsidiary for the purpose of
determining gain or loss under the general rules already stated.

However, if there is open account indebtedness between parent and
subsidiary, existing rules will apply to determine whether or not the
subsidiary realizes any gain on the liquidation. Such rules will also
apply in the case of obligations of the subsidiary held by other creditors.

Section 331 provides rules for determination of holding periods. If
the stockholder realizes capital gain or loss on the liquidation, it is
long-term or short-term depending on the holding period of his stock.
However, if he received assets in the liquidation, then the period that
the assets were held by the corporation is added to the period that the
assets are held by the stockholder after the liquidation in order to determine
whether the sale of such assets results in long-term or short-term gain
or loss. For example, if a corporation distributes in liquidation assets it
held four months and then the shareholder holds these assets three
months and sells them, he has long-term gain or loss.

Section 332 lays down the general rule that any gain or loss on
the liquidation of a corporation, whether complete or partial, is long-term
or short-term gain or loss in the case of an individual shareholder.

However, in the case of a corporate shareholder, any loss is capital
loss, but any gain is treated as a dividend. This is without regard to the
earnings and profits of the liquidating corporation. Accordingly, a
corporation having a taxable gain on the liquidation of another corporation
never has to pay more than 7% or 8% on the profit instead of the
capital gain rate of 25% or 26%. Further, if the liquidating corporation
is a subsidiary of the recipient corporation and the recipient corporation
owns more than 80% of the stock of the liquidating corporation, then
the recipient corporation gets a 100% dividends received credit for the
gain on the liquidation. This is a roundabout way of re-enacting the
provision of Section 112 (b)(6) of the old law that no gain is recognized
on the liquidation of a wholly-owned subsidiary. The new section differs
from old Section 112(b)(6) in generally allowing a loss to the parent where
the fair market value of the assets received in the liquidation is less than
the basis to the parent of the stock of the subsidiary.

Section 333 provides a new rule eliminating the double tax which was
levied pursuant to the Supreme Court decision in Court Holding Company.
There it was held that under the special circumstances the corporation owed
the tax on the profit on the sale of property, even though the property
was distributed to the stockholders and the sale of the property took place
by the stockholders. In Cumberland Public Service Co., decided later, the
Supreme Court said that the rule of the Court Holding Company case
could be avoided if certain procedures were followed. The uncertainties
arising out of these two cases and the many others which followed them
have now been eliminated, so that if the procedure in Section 333 is
followed, there will be only one tax in the event of sale of corporate
property in connection with the liquidation of a corporation, and that
tax will be paid by the shareholders. The section provides that no gain
shall be taxed to a corporation on a sale after the adoption of a plan of
partial or complete liquidation, if the sale is incident to the liquidation,
and if distribution and liquidation of all the assets of the corporation in
the case of a complete liquidation, or of all the assets of the liquidated
business in the case of a partial liquidation, occurs within the same
taxable year or the next taxable year. It is also specifically provided that
the sale or exchange of an asset after it has been distributed in partial
or complete liquidation shall not be attributed to the corporation. Section
332(c) then provides that the gain not taxed to the corporation shall be
taxed to the shareholders as long or short-term capital gain or as ordinary
income, depending on the nature of the asset, for the taxable year of the
shareholders in which the final distribution in partial or complete liquidation
is received. Under this provision it is possible that the taxation of the
gain on such a sale may be deferred until the year after the sale takes
place. For example, if the corporation adopts a plan of liquidation in
1954, and sells the property in 1954, but does not distribute its assets
in liquidation until 1955, the gain which would have been taxed to
the corporation on the sale is taxed to the shareholders in 1955.

Section 333 does not apply to a sale of assets by the corporation in
the ordinary course of business, nor to certain sales of inventory. The
first case, sale in the ordinary course of business, is described in the
Committee Report as, for example, a sale of gasoline by a gas station
after the adoption of the plan of liquidation. The exception as to inventory
assets applies where the sale of the inventory asset is for a price more
than 20% above its basis to the corporation; in such case the profit on
the sale will be taxed to the corporation.

Another provision of Section 333 is that certain inventory assets
distributed by the corporation remain inventory assets in the hands of
the stockholders, with the result that the sale or disposition of such
assets results in ordinary income and not any capital gain. For the
purpose of the rule that the sale of inventory assets results in ordinary
income, reference is made to the definition of inventory assets in Section
336(d) and (e). Under that section inventory assets include four items:
(1) property normally includible in inventory; (2) property held by the
corporation primarily for sale in the ordinary course of business; (3) rights
to income not previously included in income; (4) depreciable assets used in the trade or business (which are now generally referred to as Section 117(j) assets) held less than five years.

But these rules do not apply unless at the time of distribution, the inventory assets had a fair market value of 20% more than the basis thereof to the corporation and unless the inventory assets constituted at least 10% of the total assets of the corporation.

These rules in large part take the place of the existing provisions of law covering collapsible corporations. The present law injects into the test of collapsible corporations the question of intent, that is, it is a material question in imposing the tax under Section 117(m) what the intent of the shareholders was in dealing with the corporation. Under the new law there are objective tests determining whether a distribution in liquidation produces capital gain or ordinary income to the shareholder, and if the shareholder sells the stock of the corporation instead of liquidating it then the risk of taxation at ordinary income rates carries over to the purchaser of the stock and does not fall upon the seller of the stock. In other words, no inquiry need be made by the seller of the stock as to whether ordinary income or capital gain is involved, but the purchaser must beware since if he buys stock in a situation which will qualify under the new collapsible rules, he may find he is liable for an ordinary income tax when he liquidates the corporation and sells the inventory, and such income tax will be based on the cost of the inventory assets to the corporation and not on the cost of his stock. This loss to the purchasing shareholder of the price he has paid for the stock as the basis of the inventory is provided by Section 334. The only exception to this new collapsible procedure is that the fair market value of the inventory is less than the cost of the stock to the purchaser, a loss will be recognized at the time of liquidation; but the assets remain inventory assets in the event of subsequent sale.

Section 334 provides the rules for the basis of assets received in liquidation. Where a gain was recognized at the time of liquidation, the basis of such assets in the hands of a stockholder shall be the value used in computing such gain. Under Section 331(b) gain is computed by reference to either the basis of the asset in the hands of the corporation, or the fair market value of the asset at the time of distribution, whichever is less. The old rule, that it was fair market value in all cases, has to that extent been changed in cases where gain is recognized. But where loss is recognized then the old rule remains and the basis to the shareholder is the fair market value at the time of distribution.

Where neither gain nor loss is recognized under the new law, then the basis of the assets distributed in liquidation is the adjusted basis of the stock on which the distribution was received and in this case, the adjusted basis of the stock must be apportioned among the assets received
in liquidation in ratio to their fair market value. This provision of Section 334 codifies into the law the principles of the old Ashland Oil case which were more recently restated in the Kimbell Diamond Milling Co. case.

An exception to the rules provided by Section 334 is contained in subdivision (d) relating to distributions of inventory in liquidation. If in such case the basis of the inventory to the corporation is less than the basis of the stock to the stockholder, then the basis of the inventory in the hands of the stockholder is the same basis which it had in the corporation. This prevents a shareholder from liquidating a corporation and taking out inventory assets at capital gains rates. The new section further differs from present law in that the time of payment of the tax is postponed; the tax is not payable at the time of liquidation but at the time of later disposition of the inventory, but at such later time the gain is taxed as ordinary income and is related to the cost of the inventory to the corporation. This is the procedure by which the new law takes care of the collapsible corporation now differently covered by Section 117(m).

Section 336 contains the definitions relating to liquidations. Partial liquidation is narrowly defined. It covers only the case of a corporation which had at least two businesses which were separately operated and for which separate books were kept for a period of at least five years. Further, the liquidated business and at least one of the other businesses of the corporation must have been operating businesses as distinguished from personal holding companies and in this connection 90% of the gross income of both such businesses must have been from operations and not from investments. To qualify as a partial liquidation, there must be a plan of liquidation and the liquidation must be completed in the year in which the plan is adopted or in the next year.

Section 336 defines complete liquidation in form similar to the form now in Section 112(b)(6). The new definition of complete liquidation requires the adoption of a plan and that all the assets be distributed not later than the third taxable year following the adoption of the plan. If the liquidation extends beyond one year, the Treasury can require that a bond be put up to assure payment of the proper taxes in the event the liquidation is not completed in accordance with requirements. The three-year period may be extended by the Treasury, and the new bill does not place any limit on the period of extension. This definition of complete liquidation carries over to most complete liquidations, most of the provisions now applicable only to parent-subsidiary liquidations.

Section 336 also contains a new definition of a plan of liquidation.

Other definitions in Section 336 are those relating to inventory, and to appreciated inventory, which have been covered above; and to parent-subsidiary corporations, where the test is ownership of 80% of the voting stock and 80% of all other classes of stock.
Part III of Sub-Chapter C deals with corporate organizations, acquisitions, and separations, known under the old law as reorganizations. The terms reorganization, recapitalization, party to a reorganization and plan of reorganization do not appear in the new law. Many basic principles of the old law, such as proportionate interest in Section 112(b)(5) transactions, continuity of interest, and business purpose, are eliminated from the new law. The intention is that if the steps outlined in the new law are followed, the tax consequences will be known with certainty without regard to court interpretations. It is expressly stated in the Committee Report that motive generally will no longer be a decisive factor in determining the tax consequences of corporate adjustments.

Further, the sections dealing with corporate readjustments generally do not provide for the method of taxing distributions to shareholders in connection with such corporate readjustments; the provisions dealing with the taxation of such distributions have already been covered in the sections from 301 to 312 of Part I, and those same provisions cover most distributions in connection with corporate readjustments.

Section 351 replaces old Section 112(b)(5) and restates the general rule that a transfer by one or more persons solely for stock or securities in such corporation results in no gain or loss if such persons are in control of the corporation immediately after the exchange. But it is not necessary (as it is under present law) that the proportionate interest of the transferors which they had in the property before the transfer be retained in the form of stock in the new corporation. Even though there be a disproportion, the transfer itself will result in no gain or loss. However, if there is a disproportion, certain other tax consequences may follow: (1) There may be a gift tax to one of the transferors if he ends up with a lesser proportionate interest; (2) there may be a tax on another transferor who has received disproportionately more on the theory that he has received compensation; and in such case the transferor who received less may also have to report gain or loss on the difference between the basis of the assets he transferred to the corporation and the value of the stock which is treated as compensation to the other transferor.

Provision is also made that if in the transaction stock or securities are issued for services, they shall be taxed as compensation to the recipient although this would not affect the tax-free nature of the transaction to the remaining transferors.

To the extent that there is at the present time an overlapping between Section 112(b)(5) and other reorganization provisions, a change has been effected, since Section 351 does not apply to certain cases of acquisitions of property by one corporation from another. For example, the creation by one corporation of a new subsidiary with a part of its property will not be covered by Section 351 but by Section 359(d).

If money or other property is received by a transferor in a Section
351 transaction, gain may be recognized, but not loss; this is the same as the present law. Under Section 351 and also under Section 359(d) securities may be received tax free. These provisions are exceptional in the new bill since generally the receipt of securities will be taxed.

Section 352 is the section which refers back to Sections 305 and 306 as to the taxability of a shareholder who receives a distribution in connection with the corporate readjustments described in Part III. The general approach is that Part I shall operate with respect to a shareholder of corporation B receiving stock or securities of corporation A in a corporate adjustment as if the recipient had been a stockholder of corporation A prior to the transaction. It is immaterial whether the distribution of stock of A to the stockholders of corporation B is or is not in proportion to their holdings of stock before the transaction. On the other hand, if the distribution is not proportionate, a gift may have been made, or compensation may have been received, which would otherwise be taxed.

If in addition to stock of the distributing corporation, there are distributions of money, property or securities of the distributing corporation and/or of other corporations, the general boot rules of Section 306 would apply. For this purpose securities of the transferee corporation distributed to the shareholders of the transferor corporation are generally considered as boot.

Although the requirement that there be an exchange to attain non-taxability has been eliminated, these transactions are still taxed as exchanges in cases where the transactions do not qualify as tax-free transactions under the terms of Part III. Gain will be taxed to the transferor corporation as well as to its shareholders who receive stock or securities if the technical rules are not complied with.

In determining whether a distribution in connection with a corporate readjustment is out of earnings and profits, reference is made only to the earnings and profits of the corporation whose stock or property was acquired in the corporate readjustment.

Section 353 deals with divisive reorganizations, known under present law as split-ups, split-offs and spin-offs. There is no longer any requirement that there be an exchange of stock or securities, and the decisive effect of an exchange of stock under present law in determining whether the transaction is a split-up, split-off or spin-off is eliminated. All of these types of transactions are similarly treated. For example a corporation may distribute the stock of a controlled corporation to its stockholders generally without tax, regardless as to whether said distribution would qualify under existing law as a split-off, split-up or spin-off. The test of business purpose is eliminated; the requirement that the spin-off be of the stock of a newly organized corporation is eliminated; the requirement that the stock be of an active business corporation and not be of a holding corporation is eliminated.
The general rule is that whether the distribution results in ordinary income, or in gain or loss, depends on Sections 305 and 306, and shall be determined as though the stock or securities distributed were those of the distributing corporation; and if in addition to stock, securities, money or other property is distributed, then the boot rules of Section 306 apply.

There are two limitations on the application of this section: (1) all of the stock and securities of the controlled corporation must be distributed; and (2) the recipient stockholder must file with the Treasury an agreement that he will advise the Treasury of any subsequent disposition of the stock received. In certain cases there is a third limitation, that the stock or securities of the controlled corporation must have been acquired by the distributing corporation more than five years before the distribution, if such acquisition was pursuant to a transaction under Section 351.

The continuity of interest test is eliminated. It is not necessary that any distribution be proportionately made to all stockholders. A major change from present law is involved in that if A and B own the stock of corporation X, and A wants part of the assets and B wants the other part of the assets, corporation X may organize two new subsidiaries and distribute the stock of one of them to A and the stock of the other to B. This will be a tax-free transaction under the new law but would not have been under the old law.

The Committee Report states that Section 353 applies whether the stock of the subsidiary which is being distributed is a newly created subsidiary or an old subsidiary, and regardless of whether acquisition of the subsidiary was a taxable or a tax-free acquisition.

The new approach is to permit the distribution of stock of the controlled corporation to the stockholders of the distributing corporation without tax, but to impose the tax on the disposition of the stock in specified cases. If a stockholder has received a distribution of stock of an inactive corporation (which I will later define) then any distribution received by the stockholder of the inactive corporation, or any amount received on the disposition of the stock of the inactive corporation (including a liquidation) within a period of ten years after receipt of the stock of the inactive corporation, will result in ordinary income and not in capital gain, and this is without regard to whether the inactive corporation has earnings and profits. The sale of stock of an inactive corporation will be ordinary income in the full amount of the proceeds. Similarly in the case of liquidations or other distribution by the inactive corporation, ordinary income and not capital gains is realized.

The rules of Section 353 as regards the disposition of the stock of an inactive corporation, and the receipt of a distribution thereon, apply not only to the original holder, but to persons who have received the
stock of the original holder by gift, by inheritance, or by a combination of gift and inheritance.

The applicable period of ten years during which Section 353 operates with respect of sales of stock of an inactive corporation, and to receipt of distribution thereon, is shortened to five years if, at the time of the distribution on or disposition of the stock of the inactive corporation, 90% of its gross income had been for five successive taxable years operating income other than investment income. In such case a sale of or distribution on the stock of the inactive corporation would qualify for capital gain treatment.

The definition of inactive corporation means a controlled corporation whose stock is distributed (or its parent) unless for a period of five years such corporation or its parent operated a business as distinguished from being an investment corporation. This five year provision applies only if separate books and records were kept for the operating business for the five-year period. In order to qualify as an operating business 90% of the gross income must have been from other than investment sources.

An exception to the inactive corporation rule occurs in a case where a stockholder desires to get back the assets of an operating business from a corporation to which he had transferred it. If 90% of the gross income of the business for five years was other than investment income (or for the entire period of the existence of the business if less than five years) then if the stockholder receives in exchange for his entire interest in the corporation making the distribution, the stock of a corporation which holds the business which the stockholder had transferred to the distributing corporation, the stock which is received by the stockholder will not be deemed stock of an inactive corporation.

Section 353 requires that a stockholder or security holder receiving a distribution of stock or securities of an inactive corporation shall agree in writing to notify the Treasury of any disposition thereof within a ten year period from receipt. The Treasury has discretion to eliminate the requirement of notification if the inactive corporation ceases to be inactive.

In the event of the failure to notify the Treasury of a disposition when such notification is required the statute of limitations other wise applicable to the tax owing by reason of such disposition will not run. All these provisions are designed to insure that the spin-off method will not be used to distribute dividends or to give the stockholder an investment business to be sold at capital gain rates.

Section 354 deals with recognition of gain or loss to corporations in corporate acquisitions and separations. The general rule is that no gain or loss is recognized to a corporation which transfers property to another corporation in connection with a corporate acquisition of property or a corporate separation, even though the transferring corporation receives
securities in addition to stock. Under existing law a corporate acquisition of property is tax-free only if made solely in exchange for voting stock. The new test in a corporate acquisition of property is that as to 80% of the fair market value of the properties transferred the exchange must be solely for participating stock of the transferee, but as to any excess over 80% of the fair market value of properties transferred, the consideration may be boot, i.e., property or securities. However, in order to qualify as a tax-free transaction under the new law, the transferor corporation must be liquidated and accordingly the boot would be taxed to the shareholders of the transferor corporation under Section 306. For this purpose securities of the transferee corporation are taxed as boot under Section 306.

Section 354 also provides that no gain or loss is recognized to the transferring corporation upon the receipt of stock or securities in a corporate separation (which under present law would be known as a split-up or split-off or spin-off involving a new corporation). Here, in order to be tax-free, the transfer must be solely in exchange for stock and/or securities, and if money or other property is received from the transferee, the transaction is taxed to the transferor corporation. In the case of a tax-free corporate separation if the transferor distributes any securities received in the transaction to its stockholders, the result is that the stockholders would be taxed thereon as provided in Section 306. A condition of a tax-free corporate separation is that immediately after the transaction, the transferee corporation must be controlled by the transferor or its shareholders or persons who were shareholders of the transferor before the transaction. In such a transaction liabilities of the transferor taken over by the transferee are not treated as money.

The foregoing represents a change from existing law in that under existing law, the receipt of boot by a corporation in connection with a corporate separation is taxed to the corporation unless distributed, and such receipt does not prevent the transaction from being tax-free to the transferor; under the new law, the corporation may not receive boot at all and be free of tax, but it may receive securities of the transferee and be free of tax even though same are not distributed.

An entirely new concept of publicly held corporation is brought into the tax law by Section 354. Publicly held corporation is defined in Section 359 to include all corporations except those of which more than 50% of the voting power or of the total value of all stock is owned by ten shareholders or less, and in this connection the rules of attribution of ownership under Section 311 apply to determine ownership. In the case of publicly held corporations, no gain or loss is recognized where there are transfers for stock or for stock and property in a statutory merger or consolidation, provided only that the requisite number of voting shares of the transferor corporation are exchanged for stock of the
other corporation as required by local law. Any distributions to shareholders or security holders in such transactions will be taxed under Section 306.

No special rules are set forth for merger or consolidation of corporations not publicly held, but as to these there may be tax-free treatment depending on compliance with the requirements of Section 359(c) relating to tax-free corporate acquisitions of property.

Section 355 confers the basis to the corporation of property and stock acquired in corporation organizations, acquisitions and separations. As to property, the general rule, similar to that in the present law, is that the basis shall be the same as in the hands of the transferor, increased by any gain recognized on the transfer.

But if the transaction is an acquisition by one corporation in exchange for its participating stock, of 80% or more of the stock of another corporation, then the basis of the acquired stock is a proportionate part of the basis of the assets of the corporation whose stock was acquired. This is different from present law, under which the basis in such case would be the basis of the stock of the acquired corporation in the hands of its shareholders. In other words, in this case the basis of the stock is ignored and it is the basis of the assets which is substituted. The reason for this change seems to be that if after such an acquisition, the newly acquired subsidiary is liquidated, it is desired to obtain a result similar to that under Section 112(b)(6) of existing law, i.e., that no gain or loss shall be recognized, and that the subsidiary's basis of its assets shall carry over.

Another new provision of Section 355 deals with contributions to capital by non-stockholders. Under present law such contributions acquire a basis as was held by the Supreme Court in the Brown Shoe case. Under the new law, such property would have a zero basis. Furthermore, if the contribution is in money, and such money is then used within 12 months to acquire assets, the basis of the assets is reduced by the amount of the contributed money. This rule does not apply to transactions in which gift tax is incurred by the contributor of the property.

Section 356 states the general rule which is also in the present law that the assumption of liability, or the taking of property subject to liability, does not constitute boot to the transferor.

Also as under present law, if the purpose of the transaction as regards the liability is tax avoidance, the amount of the assumed liability is treated as money. If the tax avoidance purpose applies as to any liability, the boot rule applies as to all liabilities.

Section 356, which generally restates existing law as to assumption of liabilities, newly provides that if a transfer is subject to a liability, and the liability exceeds the basis of the property transferred, the difference is
gain to the transferor. This is a change from existing law. For example
if an individual with a piece of real estate costing $20,000 but subject
to a mortgage of $50,000 transfers it to a controlled corporation, he has
gain of $30,000 and under Section 356 this gain is treated as capital gain
and not as ordinary income regardless of the nature of the assets
transferred.

Section 356 puts an extra heavy burden of proof on the taxpayer to
establish that the assumption of liabilities was not for a tax avoidance
purpose.

Section 357 is new in the tax law and in part is designed to codify
the rule of the Survaunt case. In general, if individuals receive assets on
the complete or partial liquidation of a corporation, and within 5 years
after the final distribution transfer more than 50% of such assets to a
controlled corporation, the transaction is treated as though the assets had
been transferred directly from the first corporation to the second corporation
in a tax-free corporate acquisition of property. The fair market value of
the assets retained by the individuals is deemed to have been received
by them as boot in a corporate acquisition as of the date of transfer to
the second corporation, and a dividend may result depending upon the
amount of earnings and profits of the first corporation.

Section 357 also provides that it shall not apply to a given transaction
if it is established that the transactions do not have as one of their
principle purposes the avoidance of tax on dividends. No tests are
provided in the statute or in the Committee Report as to the meaning
of this provision.

For the purpose of this provision individuals are deemed to be in
control of a corporation if they own 50% of the voting power or 50% of
the total value of the stock; and in determining ownership the attribution
rules of Section 311 are applicable.

Section 358 provides as in present law that foreign corporations will
not qualify for tax-free treatment under Sub-chapter C unless the Treasury
is satisfied that the transaction does not have tax avoidance as one of its
principle purposes.

Section 359 contains definitions relating to corporate organizations,
acquisitions and separations. Section 359(b) defines a corporate acquisition
of stock as an acquisition in a single transaction by one corporation in
exchange for participating stock, of stock of another corporation. There
are two conditions:

1. The acquiring corporation must have control of the other corporation
immediately after the transaction. Control is ownership of 80% of all
classes of stock and of the voting power of the acquired corporation.
Clarifying present law, the section applies even though the given transaction
is not the one in which all of the stock of the acquired corporation is
obtained. It is enough if after the transaction, control exists, even though the transaction in question deals only with 5% of the stock of the acquired corporation. However, one of the tests is that there be a single transaction, but in determining a single transaction, transactions taking place at different times may be treated as one, for example where stock was being picked up from time to time pursuant to agreement.

2. The second requirement is that immediately after the transaction, the shareholders of the acquired corporation must own between 20% and 80% of the participating stock of the acquiring corporation. This extraordinary provision, nowhere explained in the Committee Report, changes existing law, and would generally prevent large corporations from taking over small corporations tax-free, since it is unlikely that stockholders of the small corporations would end up with 20% of the participating stock of the large corporation. This stock requirement does not apply if substantially all the stock of the corporation is owned directly or indirectly by the same interests.

Section 359(c) defines corporate acquisition of property as the acquisition by one corporation for its participating stock, or for the participating stock of its parent, of at least 80% of the net fair market value of the properties of another corporation. In satisfying this test of 80% of the properties, liabilities of the acquired corporation are deducted, and there is also deducted property used or retained to meet claims of the acquired corporation, if such retained amount is reasonably related to the requirements of the acquired corporation. This provision differs from present law in two respects:

(1) The present law refers to "substantially all" the properties, an uncertain test which has resulted in litigation, especially where properties are used to pay creditors or other claims, and (2) under present law the transfer must be solely for voting stock. Under the new law only 80% of the property must be solely for participating stock, and the transaction qualifies as tax-free to the corporation even though additional properties are transferred for securities, money or other property.

The first limitation on Section 359(c) is that immediately after the transaction the shareholders of a transferor corporation must own between 20% and 80% of the participating stock of the acquiring corporation. The similar requirement of section 359(b) is discussed above. This stock requirement does not apply if the corporations involved are owned by the same interests.

A second requirement of Section 359(c) is that the transferor corporation must be liquidated in accordance with the rules applicable to complete liquidations, that is within three calendar years after the transaction occurs, unless such period is extended by the Treasury.

Contrary to present law, Section 359(c) applies even though the
stock acquired by the transferor is stock other than participating stock of the transferee (i.e., it may be stock of the parent of the transferee).

Mergers or consolidations of corporations not publicly held will ordinarily fall within Section 359(c) if its terms are complied with.

Section 359(d) defines corporate separation as the transfer of part of the assets of one corporation to another corporation solely for stock or securities of the second corporation, if immediately after the transfer, transferor corporation or its shareholders or persons who were shareholders of the transferor, are in control of the transferee. It will be under this section that split-ups and split-offs and present type spin-offs will be accomplished, and transactions will qualify even though the stock of the divided portions of the old corporation go to different groups instead of proportionately to all the shareholders.