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Person to Contact:

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Distributing =

Sub =

Controlled 1 =

Controlled 2 =

State N =

A =

B =

C =

D =

E =

F =

G =

H =

I =

Dear :

This is in reply to a letter dated October 20, 1998 in which rulings were requested as to the federal income tax consequences of a proposed transaction. Additional information was submitted with and in letters dated January 20 and 28, 1999. The information submitted for consideration is substantially as set forth below.

Distributing is a State N corporation, which was incorporated in 1979, and since at least 1986 has been engaged in the following separate active businesses: operating 9 hotels and a convention center, 6 full-service restaurants, limited service restaurants, a construction company, and a campground. Distributing's outstanding 1,116 shares of voting common stock are entirely owned by second and third generation members of one family as follows: A (239 shares), B (239 shares), C (239 shares), D (239 shares), E (120 shares), F (10 shares), G (10 shares), H (10 shares), and I (10 shares).

Sub is a wholly owned subsidiary of Distributing that owns and operates five of Distributing's hotels along with the associated operating assets.

Financial information has been received which indicates that Distributing has had gross receipts and operating expenses representative of the active conduct of trades or businesses for each of the past five years.

Controlled 1 and Controlled 2 each has been formed as a State N corporation to effectuate the proposed transaction.

Serious disputes have arisen between and among Distributing's shareholders that are so significant that various active lines of business cannot be further expanded due to an informal but effective shareholder deadlock. These disputes are a result of different management styles and risk/debt tolerance of each shareholder. In order to eliminate the problems generated by these disputes, the following transaction is proposed:

- (i) Distributing will transfer the assets of its full-service restaurant business to Controlled 1 solely in exchange for all of the outstanding shares of Controlled 1 stock and the assumption by Controlled 1 of those related liabilities. Also, Distributing will transfer the assets of its limited service restaurants, campground and construction company to Controlled 2 solely in exchange for all of the outstanding shares of Controlled 2 stock and the assumption by Controlled 2 of those related liabilities.
- (ii) The assets and liabilities associated with Distributing's hotel business as well as all of the shares of Sub stock will remain with Distributing.
- (iii) Thereafter, C and I (a trust holding Distributing stock for the benefit of C's children) each will exchange all of their shares of Distributing stock for all of the outstanding 1,000 shares of stock of Controlled 1. B and F (a trust holding Distributing stock for the benefit of B's children) each will exchange all of their shares of Distributing stock for all of the outstanding 1,000 shares of stock of Controlled 2.

The following representations have been made in connection with the transaction:

- (a) Distributing, each Controlled, and their respective shareholders will each pay their own expenses incurred in connection with the transaction.
- (b) The fair market values of the stock of Controlled 1 received by C and I, and of the stock of Controlled 2 received by B and F, described in step (iii) above, will approximately equal the fair market value of Distributing's stock surrendered by each such shareholder of Distributing in the exchange.
- (c) No part of the consideration to be distributed by Distributing is being received by a shareholder as a creditor, employee, or in any capacity other than as a shareholder of the corporation.
- (d) Following the proposed transaction, Distributing and each Controlled will each continue, independently and with their separate employees, the active conduct of the businesses, previously conducted solely by Distributing.
- (e) The distributions of the stock of each Controlled is carried out for the following business purpose: the corporate separation will enhance the

success of the separate lines of business by enabling the corporations to resolve management, systemic and other problems that have arisen by Distributing operating different businesses within a single corporation.

- (f) The total adjusted basis and the fair market value of the assets to be transferred to Controlled 2 by Distributing will equal or exceed the sum of the liabilities to be assumed by Controlled 2, plus any liabilities to which the transferred assets are subject. This is not so in the instance of Distributing and Controlled1.
- (g) The liabilities to be assumed in the transaction, if any, and the liabilities to which the transferred assets are subject, if any, were incurred in the ordinary course of business and are associated with the assets transferred.
- (h) The income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(i) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of property.
- (i) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the transaction.
- (j) No intercorporate debt will exist between Distributing and either Controlled at the time of or subsequent to the proposed distribution.
- (k) No two parties to the transaction are “investment companies” as defined in § 368(a)(2)(F)(iii) and (iv) of the Code.
- (l) The five years of financial information submitted on behalf of Distributing is representative of the corporation’s present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (m) There is no plan or intention to liquidate either Distributing or either Controlled, to merge any corporation with any other corporation, or to sell or otherwise dispose of the assets of any corporation, subsequent to the transaction, except in the ordinary course of business.
- (n) There is no plan or intention by either Distributing or either Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Revenue

Procedure 96-30, 1996-1 C.B. 696.

- (o) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift (other than, possibly, by a parent into existing trusts for that shareholder's children) or otherwise dispose of any of their stock in Distributing or either Controlled subsequent to the transaction.
- (p) Distributing and the Controlled corporations have no plan or intention to elect to be treated as a S corporation under § 1361 of the Code following the transaction.
- (q) Any payments made in connection with all continuing transactions among Distributing, Controlled 1, and Controlled 2 will be on terms and conditions arrived at by the parties bargaining at arm's length.
- (r) The distribution of either Controlled stock is not part of a plan or series of related transactions within the meaning of § 355(e) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50% or more of the total combined voting power of all classes of stock of either Distributing or either Controlled, or stock possessing 50% or more of the total value of all classes of stock of either Distributing or either Controlled.

Based solely on the information submitted and on the representations set forth above, it is held as follows:

- (1) The transfer by Distributing to each Controlled of the assets described above solely in exchange for all of the stock of each Controlled and the assumption of liabilities, if any, followed by the distribution of each Controlled stock to Distributing will be each a reorganization within the meaning of § 368(a)(1)(D) of the Internal Revenue Code. Distributing and each Controlled will be "a party to a reorganization" within the meaning of § 368(b).
- (2) Gain will be recognized to Distributing upon the transfer of assets, subject to liabilities, to Controlled 1 in exchange for the shares of Controlled 1 stock, as described above (§ 357(c)). No gain or loss will be recognized to Distributing upon the transfer of assets, subject to liabilities, to Controlled 2 in exchange for Controlled 2 stock, as described above (§ 361(a) and 357(a)).
- (3) No gain or loss will be recognized to each Controlled on the receipt of the assets in exchange for the particular Controlled stock, as described above (§ 1032(a)).

- (4) The basis of the assets received by each Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the transaction described above (§ 362(b)).
- (5) The holding period of the Distributing assets received by each Controlled will include the period during which such assets were held by Distributing (§ 1223(2)).
- (6) No gain or loss will be recognized to Distributing upon the distribution of all of its Controlled 1 and Controlled 2 stock, as described above (§ 361(c)(1)).
- (7) No gain or loss will be recognized to (and no amount will be included in the income of) shareholders C, I, B and F, upon the receipt of the respective Controlled stock in exchange for their shares of Distributing stock, as described above (§ 355(a)(1)).
- (8) The basis of the Controlled stock in the hands of shareholders C, I, B and F, after the distribution, in each instance, will be the same as the basis of the Distributing stock surrendered by each in exchange therefor (§ 358(a)(1)).
- (9) The holding period of the Controlled stock received by shareholders C, I, B and F, in each instance, will include the holding period of the Distributing stock surrendered in a change therefor, provided that the Distributing stock is held as a capital asset by each shareholder on the date of the exchange (§ 1223(1)).
- (10) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Distributing and each Controlled will be made under § 1.312-10(a) of the Income Tax Regulations.
- (11) The provisions of Rev. Rul. 74-101, 1974-1 C.B. 7 will be applied, where applicable, to any “§ 38 property”.

No opinion is expressed concerning the federal income tax treatment of the proposed transaction under other provisions of the Code or Regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings.

The ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax returns of the

taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Sincerely,

Assistant Chief Counsel (Corporate)

By:

Debra L. Carlisle
Chief, Branch 5

