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Person to Contact:

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Date:
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Distributing =

Controlled =

Sub =

Business A =

Business B =

State C =

Date X =

Date Y =

a =

b =

d =

e =

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f =g =h =i =j =Shareholder M =Shareholder N =Shareholder O =Shareholder P =Shareholder Q =

This letter is in response to your request, dated February 6, 1999, for rulings relating to the federal income tax consequences of a proposed and partially completed transaction. You submitted additional information in letters dated May 1, 1999, May 18, 1999, May 26, 1999, and June 4, 1999. The information submitted for consideration is substantially as set forth below.

Distributing was established on Date X as a State C corporation. Distributing owns all of the stock of Sub, a state C corporation. Distributing and its subsidiaries will file their first consolidated return for the tax year ending December 31, 1998. Distributing uses the accrual method of accounting.

Distributing has authorized a shares of common stock of which b shares are outstanding. Distributing also has f shares of preferred stock authorized, of which g shares are outstanding. Shareholder M owns d shares of Distributing common; his brother Shareholder P owns e shares of Distributing common. Shareholders N, O, and Q each have j shares of Distributing common stock. All outstanding preferred Distributing stock is owned by Sub.

Until Date Y, Distributing was directly engaged in Business A and Business B. Distributing has submitted, for Businesses A and B, information representative of the active conduct of a trade or business for each of the past five years.

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Controlled was established on Date Y as a state C corporation and a subsidiary of Distributing. Controlled has authorized h shares of common stock, of which i shares are issued and outstanding. Distributing owns all i shares of Controlled's outstanding stock. Upon the establishment of Controlled, Distributing transferred all of the assets and liabilities of Business B to Controlled. Controlled uses the cash method of accounting.

Shareholder M and Shareholder P have been unable to agree on the expansion, debt, personnel, and other significant issues of the operation of Businesses A and B. The resulting corporate deadlock has hindered the progress and management of both businesses. The proposed transaction will allow Shareholder M and Shareholder P to each operate a business independently, alleviating the disputes and ending the corporate deadlock.

Accordingly, the following transaction is proposed and has been partially completed:

Distributing formed Controlled as a wholly owned subsidiary and transferred all of the assets of Business B to Controlled in exchange for all of the outstanding stock of Controlled. Shareholders P and Q (Shareholder P's spouse) will surrender all of their Distributing stock in exchange for all i shares of Controlled. Immediately after the distribution Shareholders M, N, and O will own all of the outstanding common stock of Distributing and Shareholders P and Q will own all of the outstanding stock of Controlled.

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

(a) The fair market value of the Controlled stock and other consideration received by each shareholder of Distributing stock approximately equals the fair market value of Distributing stock surrendered by the shareholder in exchange.

(b) No part of the consideration distributed by Distributing is being received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) Following the proposed transaction, Distributing and Controlled will each continue the active conduct of their respective businesses, independently and with their separate employees.

(d) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing will each equal or exceed the sum of the liabilities to be assumed by Controlled plus any liabilities to which the transferred assets are subject. The liabilities to be assumed in the transaction and the liabilities to which the

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transferred assets are subject were incurred in the ordinary course of the business and are associated with the assets being transferred.

(e) The indebtedness owed by Controlled to Distributing, if any, after the distribution of the Controlled stock will not constitute stock or securities.

(f) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(g) 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 statement submitted.

(h) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(i) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation subsequent to the transaction, except in the ordinary course of business.

(j) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift or otherwise dispose of any of their stock in either Distributing or Controlled subsequent to the transaction.

(k) Payments made in connection with all continuing transactions between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(l) Neither Distributing nor Controlled is an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing or Controlled to make an S corporation election pursuant to § 1362(a).

(m) The distribution 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 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

(n) There is no plan or intention by either Distributing or 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 Rev. Proc. 96-30.

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(o) Immediately before the distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Furthermore, Distributing's excess loss account, if any, with respect to the Controlled stock will be included in income immediately before the distribution.

(p) None of the assets which have been transferred from Distributing to Controlled include property for which an investment tax credit was taken in prior years.

(q) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to alleviate disputes between the Shareholders, which have hindered the ongoing management, operations, and expansion of Distributing. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.

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

(1) The transfer by Distributing to Controlled of the assets described above in exchange for all the stock of Controlled and the assumption of certain liabilities followed by the distribution of Controlled stock to Shareholders P and Q, in exchange for Distributing stock, will qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).

(2) No gain or loss will be recognized to Distributing upon the transfer of assets to Controlled in exchange for Controlled stock and the assumption of liabilities (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized to Controlled on the receipt of the assets in exchange for all the shares of Controlled (§ 1032(a)).

(4) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the transaction (§ 362(b)).

(5) The holding period of each asset received by Controlled will include the period during which Distributing held the asset (§ 1223(2)).

(6) No gain or loss will be recognized to Distributing upon the distribution of the Controlled stock in exchange for the Distributing stock surrendered by Shareholders P and Q (§ 361(c)).

(7) No gain or loss will be recognized to Shareholders P and Q (and no amount

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will be included in the income of Shareholders P and Q) upon receipt of Controlled stock (§ 355(a)(1)).

(8) The basis of the Controlled stock to be received by Shareholders P and Q will equal the basis of the Distributing stock exchanged therefor (§ 358(a)(1)).

(9) The holding period of the Controlled stock in the hands of Shareholders P and Q will include the period for which such shareholder held the Distributing stock, provided that such stock was held as a capital asset by such shareholder on the day of distribution (§ 1223(1)).

(10) Proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) and § 1.1502-33.

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

This 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.

Each affected taxpayer should attach a copy of this letter to its federal income tax return for the taxable year in which the transaction covered by this ruling letter is consummated.

Sincerely yours,

Assistant Chief Counsel (Corporate)

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By *Ken Cohen*

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