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Distributing =

Controlled =

State Y =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

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L =

M =

N =

O =

P =

Q =

R =

S =

T =

U =

V =

W =

X =

business a =

Date 1 =

This letter replies to a request for rulings, dated March 20, 2000, on the federal income tax consequences of a proposed transaction concerning § 355 of the Internal Revenue Code. We received additional information in letters dated April 5, April 22, May 15, May 30, and June 16, 2000. The information submitted for consideration is summarized below.

Distributing is a State Y company with voting and non-voting common stock and voting and non-voting preferred stock outstanding. The stock is held by members of an extended family. Distributing conducts business a on the accrual method of accounting and uses a fiscal tax year.

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We have received financial information indicating that Distributing's business a has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

The taxpayer wishes to separate its business a activities into two corporations because shareholders A and T disagree on how business a should be conducted. T is willing to accept greater risks in the operation of business a than shareholder A. This disagreement is having an adverse effect on the day-to-day operations of Distributing. In order to eliminate the problems generated by this situation, the following transaction has been proposed:

- (i) Distributing will organize Controlled as a State Y accrual basis corporation with voting and non-voting common and voting and non-voting preferred stock outstanding. Distributing will transfer a portion of the business a assets (the "Controlled assets") to Controlled in exchange for the assumption of related liabilities and all of the Controlled stock.
- (ii) Distributing will distribute all of the Controlled stock to shareholder A and members of his family, B through J and (partnership) X, ("Group A") in exchange for all of their Distributing stock. Group A shareholders will receive the same type and class of stock in Controlled that they held in Distributing. (For example, shareholders who held voting common stock in Distributing would receive voting common stock in Controlled).

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) The fair market value of the Controlled stock and other consideration to be received by each member of Group A approximately equals the fair market value of the Distributing stock surrendered by each member of Group A in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) 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.
- (d) Following the transaction, Distributing and Controlled will each continue independently and with its own separate employees, the active conduct of its

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share of all of the integrated activities of business a.

- (e) The distribution of stock of Controlled is being carried out for the following corporate business purpose: to eliminate irreconcilable differences between A and I concerning the management and operation of business a. The distribution of the stock of Controlled is motivated in whole, or substantial part, by this corporate business purpose.
- (f) 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 proposed transaction other than the redemptions described in paragraph (g), below.
- (g) 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 except for the redemptions of stock of shareholders B, E, K, L, M, N, P, Q, R, S, U, V, and W. These redemptions will be made under the terms of agreements to redeem the shares made over ten years ago on Date 1.
- (h) There is no plan or intention to liquidate 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.
- (i) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing will each equal or exceed the sum of the liabilities assumed by Controlled plus any liabilities to which the assets transferred are subject. The liabilities to be assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (j) No Investment tax credit under § 46 has been claimed (or will be claimed) on the property to be transferred to Controlled.
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (l) Payments made in connection with all continuing transactions, if any, 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.
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

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- (n) Distributing is not 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)
- (o) 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 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.
- (p) Neither the existing Distributing preferred stock nor the Controlled preferred stock to be issued is section 306 stock as defined within § 306(c) of the Code.

Based solely on the information submitted and the representations set forth above, we hold as follows:

- (1) The transfer by Distributing to Controlled of the Controlled assets solely in exchange for all of the stock of Controlled, as described above, followed by the distribution of all of the Controlled stock to Group A in exchange for all of their Distributing stock will be 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) Distributing will recognize no gain or loss upon the transfer of assets, subject to liabilities, to Controlled in exchange for Controlled stock, as described above (§§ 361(a) and 357(a)).
- (3) Controlled will recognize no gain or loss on the receipt of Controlled assets in exchange for Controlled stock (§ 1032(a)).
- (4) The basis of each asset received by Controlled will be the same as the basis of that asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (5) The holding period of the Controlled assets will include the period during which these assets were held by Distributing (§ 1223(2)).
- (6) Group A will not recognize gain or loss (and no amount will be included in the income of Group A) upon the receipt of the Controlled stock in exchange for all of their Distributing stock, as described above (§ 355(a)(1)).
- (7) Distributing will recognize no gain or loss upon the distribution of all of its Controlled stock (§ 361(c)).

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- (8) The basis that each member of Group A will receive in its Controlled stock will equal the aggregate basis of its Distributing stock surrendered in the exchange (§ 358(a)(1)).
- (9) The holding period of the Controlled stock received by each member of Group A will include the holding period of the Distributing stock surrendered in the exchange, provided that the Distributing stock is held as a capital asset on the date of the exchange (§ 1223(1)).
- (10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) of the Income Tax Regulations.

No opinion was requested and no opinion is expressed about the redemptions described in paragraph (g), above. Additionally, we express no opinion about the tax treatment of the proposed 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 proposed transaction that are not specifically covered by the above rulings.

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

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

We have sent a copy of this letter to your authorized representative pursuant to the power of attorney on file in this office.

Sincerely yours,
Assistant Chief Counsel (Corporate)

By Ken Cohen
Senior Technician Reviewer, Branch 3