

**Internal Revenue Service**

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

November 21, 2000

**LEGEND:**

Distributing =  
Controlled =  
Business =  
State =  
Shareholder A =  
Shareholder B =  
Shareholder C =  
Trust D =  
Trust E =  
Trust F =

Dear :

This letter is in response to your letter dated July 13, 2000 requesting rulings regarding the tax consequences of a proposed transaction. You submitted additional information in letters dated September 20 and October 30, 2000. The information submitted is summarized below.

Distributing is a State corporation engaged in Business. Distributing is an S corporation that utilizes the cash method of accounting and has a December 31 taxable year end. Distributing is owned 51% by Shareholder A, 29% by Shareholder B, and 20% by Shareholder C. Shareholder A holds his shares as trustee of Trust D. Shareholder B holds his shares as trustee of Trust E. Shareholder C holds his shares as trustee of Trust F. Trust D, Trust E, and Trust F are grantor trusts.

Controlled is a State corporation wholly owned by Distributing. Controlled is a Qualified Subchapter S Subsidiary (QSub).

The taxpayer has submitted financial information indicating that Distributing has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five years. On the date of the proposed transaction, Controlled will have assets and employees necessary for the active conduct of Business.

Disputes have arisen between Shareholder A and Shareholder B that are negatively impacting Business. To eliminate these disputes, the taxpayers propose that Shareholder B will surrender to Distributing all of his Distributing stock in exchange for all the stock of Controlled.

The taxpayers have made the following representations about the proposed transaction:

- (a) The fair market value of the Controlled stock received by Shareholder B will be approximately equal to the fair market value of the Distributing stock surrendered by Shareholder B in the exchange.
- (b) No part of the consideration distributed by Distributing will be received by Shareholder B as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to Distributing there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, Distributing and Controlled each will continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior to consummation of the transaction.
- (e) The distribution of Controlled stock is being carried out for the following corporate business purposes: to resolve shareholder conflict, to accommodate different goals or business techniques of each shareholder, and to maximize profit potential. . The transaction is motivated, in whole or substantial part, by these corporate business purposes.
- (f) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of their stock in either Distributing or Controlled after the transaction.
- (g) There is no plan or intention by 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 section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

- (h) There is no plan or intention for Distributing or Controlled to liquidate, to merge with any other corporation, or to sell or otherwise dispose of the assets of any corporation after the transaction, except in the ordinary course of business.
- (i) Controlled will not assume any liabilities in the transaction.
- (j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (k) No parties to the transaction are investment companies as defined in sections 368(a)(2)(F)(iii) and (iv) of the Internal Revenue Code.
- (l) Payments made in 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) Distributing is an S corporation. Controlled is a Qualified Subchapter S Subsidiary. Controlled will elect to be an S corporation on the first available date after the distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

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

- (1) Distributing will recognize no gain or loss upon the distribution of all the Controlled 1 stock (section 361(c)(1)).
- (2) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholders upon the receipt of the Controlled stock by Shareholder B or the retention of Distributing stock by Shareholder A and Shareholder C (section 355(a)(1)).
- (3) The basis of the stock of Controlled in the hands of Shareholder B will be the same as the aggregate basis of the Distributing stock surrendered in exchange therefor (section 358(a)(1)). The transaction will have no effect on Shareholder A or Shareholder C's bases in their Distributing stock.
- (4) The holding period of Controlled stock received by Shareholder B will include the holding period of Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a

capital asset on the date of the exchange (section 1223(1)). The transaction will have no effect on the holding period in the Distributing stock held by Shareholder A and Shareholder C.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings, and such information is therefore subject to verification on examination.

Except as expressly provided herein, we express no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayers on whose behalf it was requested. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,  
Associate Chief Counsel (Corporate)  
By: Theresa Abell  
Acting Senior Technician Reviewer  
Branch 1