

# Internal Revenue Service

Department of the Treasury

Number: **200134010**

Washington, DC 20224

Release Date: 8/24/2001

Index Number: 355.01-01, 368.04-00

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Refer Reply To:

**CC:CORP:4-PLR-109932-01**

Date:

**May 23, 2001**

Distributing =

Controlled =

State X =

Business Y =

A =

B =

C =

D =

E =

Trust =

a =

b =

c =

d =

This letter responds to your February 7, 2001 request for rulings on certain federal income tax consequences of a proposed transaction. Additional information was requested and submitted in letters dated April 23 and May 21, 2001. The information submitted for consideration is summarized below.

### **Summary of Facts**

Distributing, a State X corporation, files its federal income tax return on a calendar year basis and uses the cash method of accounting. The Distributing stock is owned a percent by A, b percent by A's sister-in-law, B, and c percent by each of B's children, C and D. The remaining d percent is held by Trust, a testamentary trust created under the Will of E, the father of B, and of which B, C, and D are beneficiaries. B, C, D, and Trust are hereinafter referred to collectively as the "Family."

Distributing directly engages in Business Y. Distributing has submitted financial information indicating that Business Y has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

A and the Family have differed on a number of fundamental business matters relating to Distributing's business, including management approach and expansion of Distributing's business. These differences are having an adverse effect on the day-to-day operations of Distributing. Furthermore, A and the Family anticipate that the death of any one of the major shareholders of Distributing will aggravate these differences.

### **Proposed Transaction**

To eliminate the shareholder disputes, Distributing has proposed the following series of steps (collectively, the "Proposed Transaction"):

(i) Distributing will form Controlled under the laws of State X. Controlled, like Distributing, will use the cash method of accounting and file its federal income tax return on a calendar year basis.

(ii) Distributing will contribute approximately a percent (based on fair market

values) of its assets to Controlled in exchange for all of Controlled's outstanding stock (consisting only of voting common) and the assumption by Controlled of related liabilities (the "Contribution").

(iii) Distributing will distribute all of Controlled's stock to A in exchange for all of his Distributing stock (the "Distribution").

### **Representations**

The taxpayer has made the following representations concerning the Proposed Transaction:

(a) The fair market value of the Controlled stock received by A will approximately equal the fair market value of the Distributing stock surrendered by A in the exchange.

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

(c) The five years of financial information submitted on behalf of Distributing represents Distributing's present operations and, with regard to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.

(d) Following the Proposed 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 before consummation of the Proposed Transaction.

(e) The Distribution is carried out for the corporate business purpose of allowing A and Family to operate independently of one another. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(f) Distributing is not an S corporation (under § 1361(a) of the Internal Revenue Code), and neither Distributing nor Controlled expects or plans to make an S corporation election under § 1362(a) in the near future.

(g) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the Proposed Transaction.

(h) 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

Proposed Transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

(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 after the Proposed Transaction, except in the ordinary course of business.

(j) No Distributing shareholder will hold immediately after the Distribution “disqualified stock” within the meaning of § 355(d)(3) that constitutes a 50 percent or greater interest in Distributing or Controlled.

(k)(i) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under § 357(d)) by Controlled; and

(ii) The liabilities assumed (as determined under § 357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

(l) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.

(m) Payments made in connection with any 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.

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

(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 entitled to vote 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.

### **Rulings**

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

(1) The Contribution, followed by the Distribution, will be a reorganization under

§ 368(a)(1)(D). Distributing and Controlled each will be a party to a reorganization under § 368(b).

(2) No gain or loss will be recognized by Distributing on the Contribution (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).

(4) The basis that Controlled has in each asset received from Distributing will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).

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

(6) No gain or loss will be recognized by Distributing upon the Distribution (§361(c)(1)).

(7) No gain or loss will be recognized by A upon his receipt of Controlled stock in the Distribution (§ 355(a)(1)).

(8) The basis of the stock of Controlled in the hands of A immediately after the Distribution will equal the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

(9) The holding period of the Controlled stock received by A will include the period during which A held the Distributing stock with respect to which the Distribution is made, provided that the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(10) Proper allocation of Distributing's earnings and profits will be made under § 1.312-10(a) of the Income Tax Regulations.

### **Caveats**

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 it is subject to verification on examination.

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations, or 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.

### **Procedural Statements**

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,  
Associate Chief Counsel (Corporate)

By: *Wayne J. Murray*  
Senior Technician Reviewer  
Branch 4