

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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CC:CORP:B05-PLR-123798-01
Date:
September 26, 2001

In re:

LEGEND:

Distributing =

Controlled =

State =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Business A =

Year 1 =

a =

b =

c =

PLR-123798-01

2

d =

e =

f =

Properties A =

Properties B =

This responds to your letter dated April 19, 2001, in which rulings are requested regarding the federal income tax consequences of a proposed transaction. The information submitted in the request and in subsequent correspondence is summarized below.

Distributing is incorporated in State. For federal income tax purposes, Distributing uses a cash method of accounting and files its federal income tax returns on the basis of a fiscal taxable year ending on June 30. Distributing is engaged in Business A. Distributing has e shares outstanding of Class A voting stock and f shares outstanding of Class B nonvoting stock. The Class A stock is equally owned by Shareholder A and Shareholder C. The Class B stock is owned by Shareholder A, Shareholder C and their respective trusts in the following proportions: Shareholder A owns a percent; Shareholder B (a trust for the benefit of Shareholder A) owns b percent; Shareholder C owns c percent; and Shareholder D (a trust for the benefit of Shareholder C) owns d percent.

Distributing was incorporated in Year 1. Financial information has been received indicating that Business A has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five years.

The shareholders believe that a separation of Distributing would resolve irreconcilable shareholder disagreements over the management of Business A. They also maintain that productivity will be enhanced if each shareholder is able to focus attention and effort on the management and operation of a portion of Distributing's Business A. Accordingly, a transaction is proposed to provide for separate ownership and management of the business now conducted by Distributing as follows:

- (i) Distributing will form Controlled as a wholly owned subsidiary. Distributing will transfer a portion of the assets of Business A, including Property A, to Controlled solely in exchange for shares of Controlled Class A voting common stock, Controlled Class B nonvoting common stock and the assumption of Controlled liabilities.
- (ii) Distributing will retain a portion of the assets and operations of Business A including Property B.
- (iii) Distributing will distribute all of its Controlled stock to Shareholder A and Shareholder B in exchange for all of the Distributing stock of Shareholder A and Shareholder B.

The taxpayer has made the following representations with respect to the proposed transaction:

- (a) The fair market value of the Controlled stock and other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by a security holder as an employee or in any capacity other than that of a security holder of Distributing.
- (c) The 5 years of financial information submitted on behalf of Distributing is representative of 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 transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all of the integrated activities of the business conducted by Distributing prior to consummation of the transaction.
- (e) The distribution of the stock, or stock and securities, of Controlled is carried out for the corporate business purpose of resolving shareholder disputes and for allowing the shareholders to go their own way. The distribution of the stock, or stock and securities, of Controlled is motivated, in whole or substantial part, by such business purposes.
- (f) 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 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 § 4.05(1)(b) of Rev. Proc. 96-30.
- (h) 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 transaction, except in the ordinary course of business.
- (i) The total adjusted bases and fair market values 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.

- (j) 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.
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the 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).
- (n) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (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 total combined voting power of all classes of stock of Distributing or Controlled or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.
- (p) Distributing, Controlled and their respective shareholders will each pay their own expenses, if any, incurred in connection with the proposed transaction.
- (q) 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 Distributing.

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

- (1) The transfer by Distributing to Controlled of a portion of the assets associated with Business A solely in exchange for all of the outstanding Controlled stock, and the assumption of liabilities associated with Business A, followed by the distribution of all of the Controlled stock to Shareholder A and Shareholder B in exchange for all of their stock in Distributing 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) No gain or loss will be recognized by Distributing upon its transfer of the assets to Controlled in exchange for stock and Controlled's assumption of

liabilities ((§§ 361(a) and 357(a)).

- (3) No gain or loss will be recognized by Controlled upon the receipt of the assets of Distributing in exchange for the stock of Controlled and the assumption of liabilities (§ 1032(a)).
- (4) The basis in the assets to be 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 the Distributing assets to be received by Controlled will include the period during which such assets were held by Distributing (§ 1223(2)).
- (6) No gain or loss will be recognized to (and no amount will be included in the income of) Shareholder A and Shareholder B upon the receipt of the stock of Controlled in exchange for all of their Distributing stock (§ 355(a)(1)).
- (7) The holding period of the Controlled stock received by Shareholder A and Shareholder B will include the holding period of the Distributing stock surrendered in exchange therefor, provided that such Distributing stock is held as a capital asset on the date of the exchange (§ 1223(1)).
- (8) 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.
- (9) No gain or loss will be recognized to Distributing upon the distribution of all of its stock in Controlled to Shareholder A and Shareholder B in exchange for all of their Distributing stock (§ 361(c)(1)).
- (10) The basis of the Controlled stock in the hands of Shareholder A and Shareholder B will be the same immediately after the exchange as the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

No opinion is expressed about the tax treatment of the transaction under other provisions of the Code and the 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) 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 each

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

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to Shareholder A, President of Distributing.

Sincerely yours,
John Moriarty
Assistant to the Branch Chief, Branch 5
Office of the Associate Chief Counsel
(Corporate)

cc: