

Internal Revenue Service

Department of the Treasury

Number: **200310009**

Washington, DC 20224

Release Date: 3/7/2003

Index Numbers: 368.04-00
355.01-01

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:B06-PLR-150298-02

Date:

November 26, 2002

Legend

Distributing =

Target =

Controlled =

Assets =

Business =

A =

B =

C =

D =

The D Trust =

E =

F =

The F Trust =

The G Trust =

a% =

b% =

c% =

d% =

e% =

f% =

g% =

h% =

i% =

j% =

Dear :

This letter responds to your letter dated September 5, 2002, submitted on your behalf by your authorized representative, requesting rulings under I.R.C. §§ 368 and 355. Additional information was received in letters dated October 21 and November 6, 2002. The information submitted in your letters is summarized below.

Distributing and Target are closely held common controlled corporations with horizontally integrated businesses. Target is engaged in Business and Distributing holds Assets, which it leases to Target, and also maintains. The shareholders of Distributing are A (c%), B (d%), C (b%), The D Trust (d%) and The F Trust (d%). The shareholders of Target are A (e%), B (a%) and The G Trust (e%).

A is the sole beneficiary of The G Trust. B, D and E are A's daughters. B and C are husband and wife, and D is the trustee and beneficiary of The D Trust. E and her husband, F, are the trustees of The F Trust. As trustees, E and F have the sole power to vote the Distributing stock owned by the F Trust. At the end of the Trust's life, the corpus will inure to E and F's children.

E and her husband, on the one hand, and A, B and C, on the other hand, have divergent views as to the current operations and future direction of the Business. To address this problem and to allow each group of shareholders to concentrate on the business that that group is interested in, the parties have devised the following plan:

- (1) Target will merge with and into Distributing in a statutory merger that is intended to qualify as tax-free under I.R.C. § 368(a)(1)(D). After this merger, the shareholders of Distributing will be A (h%), B (j%), C (f%), The D Trust (i%), The F Trust (i%) and The G Trust (g%).
- (2) Distributing will redeem all of its stock held by The D Trust in exchange for two notes. Each note will represent the redemption of the Trust's interests in the separate businesses conducted by Distributing. It is intended that this redemption will qualify as a complete termination of interest within the meaning of I.R.C. § 302(b)(3).
- (3) Distributing will form Controlled by contributing to it part of its Business, as well as one of the notes, which is attributable to the part of the Business transferred to it.
- (4) Distributing will distribute all of its interests in Controlled to The F Trust in exchange for all of its interests in Distributing.
- (5) Distributing and Controlled will each make elections to be taxed as "S" corporations.

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

- (a) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled (as determined under section 357(d)).
- (b) The liabilities assumed in the transaction (as determined under section 357(d)) were incurred in the ordinary course of business and are associated with the assets being transferred.
- (c) No investment credit determined under section 46 has been (or will be) claimed

with respect to any property transferred between Distributing and Controlled.

- (d) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the Distribution.
- (e) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, except for indebtedness incurred in the ordinary course of business or for obligations resulting from arm's-length agreements to share services or facilities for a brief transitional period.
- (f) Subsequent to the Distribution, Distributing and Controlled may be engaged in a certain transaction for a transitional period. Payments made in connection with such transaction, 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.
- (g) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (h) The indebtedness, if any, owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (i) No part of the consideration to be distributed by Distributing will be received by a shareholder of Distributing as a creditor, employee or in any capacity other than that of a shareholder of Distributing.
- (j) The fair market value of Controlled stock and other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of Distributing stock surrendered by the shareholder in the exchange.
- (k) The five years of financial information submitted on behalf of Distributing is representative of its present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (l) The gross assets of the part of the Business directly conducted by Distributing immediately after the Distribution will have a fair market value that is greater than 5 percent of the total fair market value of Distributing's gross assets at that time.
- (m) The five years of financial information submitted by Distributing on behalf of Controlled is representative of Distributing's present operations of that part of the Business, and with regard to such portion of the Business, there have been no substantial operational changes since the date of the last financial statements submitted.

- (n) The gross assets of the part of the Business to be conducted by Controlled immediately after the Distribution will have a fair market value that is greater than 5 percent of the total fair market value of Controlled's gross assets at that time.
- (o) Following the Distribution, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of the Business conducted by Distributing prior to the consummation of the transaction.
- (p) The distribution of Controlled is primarily carried out for the following corporate business purpose: Fit and Focus. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (q) There is no plan or intention by any shareholder to sell, exchange, transfer by gift or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the Distribution.
- (r) Except for the redemption described in step (2), 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 Distribution, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (s) 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 Distribution, except in the ordinary course of business.
- (t) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (u) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was

acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

- (v) The Distribution is not a part of a plan or series of related transactions (within the meaning of section 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.
- (w) Distributing is not an "S" corporation (within the meaning of section 1361(a)), but immediately before the Distribution, Distributing will be eligible to make an "S" corporation election pursuant to section 1362(a). Distributing and Controlled will elect to be an "S" corporation pursuant to section 1362(a) on the first available date after the Distribution, and there is no plan or intention to revoke or otherwise terminate the "S" corporation election of either Distributing or Controlled.
- (x) The merger described in step (1) will qualify as a tax-free reorganization under section 368(a)(1)(D), and no gain or loss will be recognized in whole or in part as a result of the merger.
- (y) After the Distribution, The F Trust will not retain an interest in Distributing (including an interest as an officer, director, employee, or creditor).

Based solely on the information submitted and the representations made, we have concluded that:

- (1) The transfer by Distributing of part of the Business to Controlled in exchange for all of the Controlled voting common stock and the assumption by Controlled of certain liabilities, followed by the non-pro rata distribution by Distributing of all of the Controlled stock to The F Trust, will constitute a reorganization within the meaning of section 368(a)(1)(D) of the Internal Revenue Code. Distributing and Controlled will each be a "party to the reorganization" within the meaning of section 368(b).
- (2) No gain or loss will be recognized by Distributing upon its receipt of Controlled stock in exchange for the transfer of assets to, and the assumption of liabilities by, Controlled. Section 361(a) and (b)(1) and section 357(a).
- (3) No gain or loss will be recognized by Controlled upon its receipt of assets in exchange for its issuance of shares of Controlled stock. Section 1032(a).

- (4) Controlled's basis in the assets received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transfer. Section 362(b).
- (5) The holding period of each asset received by Controlled from Distributing will include the period during which Distributing held such asset. Section 1223(2).
- (6) Distributing will not recognize gain or loss upon the Distribution of the stock in Controlled to The F Trust. Section 361(c)(1).
- (7) No gain or loss will be recognized to (and no amounts will be included in the income of) The F Trust upon its receipt of Controlled stock. Section 355(a)(1).
- (8) The basis of the Controlled stock in the hands of The F Trust will be the same as the basis of the Distributing stock surrendered in exchange therefor. Section 358(a)(1).
- (9) The holding period of the Controlled stock received by The F Trust will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset on the day of the Distribution. Section 1223(1).
- (10) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with Treas. Reg. section 1.312-10(a).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed concerning the tax consequences of steps (1), (2) and (5).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code 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.

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. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Reginald Mombrun

Reginald Mombrun
Assistant Branch Chief, Branch 6
Office of Associate Chief Counsel
(Corporate)

cc: