

Internal Revenue Service

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LEGEND

Distributing =

Controlled 1 =

Controlled 2 =

Controlled 3 =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Business A =

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Business B =

a =b =c =d =

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This letter responds to your January 16, 2003 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

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.

Summary of Facts

Distributing is a holding company that files a consolidated return with wholly owned Controlled 1, Controlled 2, and Controlled 3 (together, the "Controlled Corporations"). Distributing has two classes of stock outstanding, voting common stock and nonvoting common stock. Shareholder 1 owns a percent of the voting common stock and b percent of the nonvoting common stock. Shareholder 2, Shareholder 3, and Shareholder 4 each own c percent of the voting common stock and d percent of the nonvoting common stock.

Controlled 1 and Controlled 3 conduct Business A and Controlled 2 conducts Business B.

Financial information has been received indicating that Business A of Controlled 1, Business A of Controlled 3, and Business B of Controlled 2 each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Serious disputes have arisen among Shareholder 2, Shareholder 3, and Shareholder 4 that are having an adverse effect on the day-to-day operation of Distributing and the Controlled Corporations. Further, Shareholder 2, Shareholder 3, and Shareholder 4 wish to divide the Controlled Corporations and go their separate ways.

Proposed Transaction

Distributing proposes a redemption and corporate separation as set forth below (the "Proposed Transaction").

- (i) Distributing will redeem all of Shareholder 1's stock in Distributing in exchange for cash and other assets (the "Redemption").
- (ii) Distributing will distribute the Controlled 1 stock to Shareholder 2 in exchange for Shareholder 2's Distributing stock.
- (iii) Distributing will distribute the Controlled 2 stock to Shareholder 3 in exchange for Shareholder 3's Distributing stock.
- (iv) Distributing will distribute the Controlled 3 stock to Shareholder 4 in exchange for Shareholder 4's Distributing stock. (Collectively, steps (ii) through (iv), the "Distribution").
- (v) Following the Distribution, Distributing will liquidate.

Representations

Distributing has made the following representations with respect to the Proposed Transaction:

- (a) The fair market value of the Controlled 1, Controlled 2, and Controlled 3 stock received by Shareholder 2, Shareholder 3, and Shareholder 4, respectively will approximately equal the fair market value of the Distributing stock surrendered by each in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by Shareholder 2, Shareholder 3, and Shareholder 4 as a creditor, employee, or in any capacity other than that of a Distributing shareholder.
- (c) The five years of financial information submitted on behalf of Controlled 1, Controlled 2, and Controlled 3 represents each corporation's present operations, and with regard to each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

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- (d) Following the Distribution, the Controlled Corporations will each continue the active conduct of its business, independently and with its own employees.
- (e) The Distribution is carried out for the following corporate business purposes: To end shareholder disputes over the operation of the Controlled Corporations and to enable Shareholder 2, Shareholder 3, and Shareholder 4 to go their own way. The Distribution is motivated, in whole or substantial part, by these corporate business purposes.
- (f) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing or the Controlled Corporations to make an S election pursuant to § 1362(a).
- (g) There is no plan or intention by Shareholder 2, Shareholder 3, or Shareholder 4 to sell, exchange, transfer by gift, or otherwise dispose of any stock in the Controlled Corporations after the Distribution.
- (h) There is no plan or intention by the Controlled Corporations, 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 § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.
- (i) There is no plan or intention to liquidate any of the Controlled Corporations, to merge any of the Controlled Corporations with any other corporation, or to sell or otherwise dispose of the assets of any of the Controlled Corporations after the Distribution, except in the ordinary course of business.
- (j) No intercorporate debt will exist between Distributing and the Controlled Corporations at the time of, or subsequent to the Distribution.
- (k) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Further, any excess loss account Distributing may have in any Controlled Corporation stock will be included in income immediately before the Distributions to the extent required by applicable regulations.
- (l) Payments made in connection with any continuing transactions between Controlled 1, Controlled 2, and Controlled 3 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (m) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50

percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, 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 § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

- (n) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled 1, Controlled 2, or Controlled 3 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled 1, Controlled 2, or Controlled 3 stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 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 § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (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 Controlled 1, Controlled 2, or Controlled 3 stock entitled to vote, or stock possessing 50 percent or more of the total value of all classes of Controlled 1, Controlled 2, or Controlled 3 stock.

Rulings

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

- (1) Amounts received by Shareholder 1 in the Redemption will be treated as full payment in exchange for the Distributing stock surrendered (§ 331(a)).
- (2) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Shareholder 2, Shareholder 3, and Shareholder 4 on the Distribution (§ 355(a)(1)).
- (3) No gain or loss will be recognized by Distributing on the Distributions (§ 355(c)).
- (4) The basis of the Controlled 1 stock received by Shareholder 2, the Controlled 2 stock received by Shareholder 3, and the Controlled 3 stock

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received by Shareholder 4 will equal the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

- (5) The holding period of the Controlled 1 stock received by Shareholder 2, the Controlled 2 stock received by Shareholder 3, and the Controlled 3 stock received by Shareholder 4 will include the holding period of the Distributing stock exchanged therefor, provided the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (6) As provided in § 312(h), proper allocation of earnings and profits among Distributing, Controlled 1, Controlled 2, and Controlled 3 will be made under § 1.312-10(b) of the Income Tax Regulations.

Caveats

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. In particular, no opinion is expressed regarding the liquidation of Distributing following the Distribution.

Procedural Statements

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

Each taxpayer involved in this transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the transaction covered by this letter is completed.

Under a power of attorney on file in this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Corporate)

cc: