



PLR-130025-03

bb =

cc =

dd =

ee =

ff =

business m =

business n =

state Z =

Dear \_\_\_\_\_ :

This letter responds to your May 8, 2003 request for rulings on certain Federal tax consequences of a proposed transaction. Additional information was received in letters dated July 15, 2003 and August 29, 2003. Additional information was also provided in a conference call conducted on September 10, 2003. The information submitted for consideration is substantially as set forth below.

Distributing is a state Z Subchapter S corporation engaged in business m and business n. Distributing has six shareholders. Shareholder A owns aa percent of Distributing; Shareholder B owns bb percent; Shareholders C, D, E, and F own the remaining cc percent. Distributing conducts business m and business n on the accrual method of accounting and uses a calendar tax year.

We have received financial information indicating that business m and business n each has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

The taxpayer wishes to separate its business m and business n activities into two corporations because Shareholders A and B disagree on how business m and business n should be conducted. In order to eliminate the problems generated by this situation, the following transaction has been proposed:

PLR-130025-03

- (i) Pursuant to a plan of agreement and reorganization, Distributing will cause Controlled to be incorporated as a state Z corporation. Controlled will use the accrual method of accounting.
- (ii) Distributing will transfer business assets relating to business n to Controlled, in exchange solely for all of the outstanding stock of Controlled.
- (iii) Distributing will distribute all of the Controlled stock to Shareholder A in exchange for Distributing stock of equal value.

Following the transaction, Controlled will be wholly owned by Shareholder A. Also, Shareholder B will own dd percent (over 50 percent), Shareholder A will own ee percent, and Shareholders C, D, E, and F will own ff percent of Distributing.

The taxpayers have made the following representations in connection with 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 shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The five years of financial information submitted on behalf of Distributing is representative of its present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the proposed transaction, Distributing and Controlled will each continue the active conduct of their respective businesses, independently and with their own separate employees.
- (e) The distribution of the stock of Controlled is being carried out for the following corporate business purpose: avoiding significant disagreements between Shareholders A and B of Distributing concerning the management of business m and business n. The distribution of the stock of Controlled is motivated in whole, or in substantial part, by this corporate business purpose.

PLR-130025-03

- (f) There is no existing indebtedness between Controlled and Distributing. No such indebtedness will exist immediately after the transaction, and there is no plan or intention to create any indebtedness between Controlled and Distributing in the 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 transaction. As a part of their normal family planning, Shareholder A and Shareholder B may from time to time make gifts of stock to members of their families, but not to each other.
- (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 transaction, other than through stock purchases meeting the requirements of §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, subsequent to the proposed transaction, except in the ordinary course of business.
- (j) The assets to be contributed to Controlled will not be subject to any liabilities, and Controlled will assume no liabilities of Distributing in connection with the proposed transaction.
- (k) No property is being transferred between Distributing and Controlled with respect to which any investment credit has been or will be claimed.
- (l) There is no existing indebtedness between Controlled and Distributing. No such indebtedness will exist immediately after the transaction, and there is no plan or intention to create any indebtedness between Controlled and Distributing in the future.
- (m) 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.
- (n) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv).

PLR-130025-03

- (o) The distribution of stock in Controlled 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 fifty percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing fifty percent or more of the total value of all classes of stock of Distributing or Controlled.
- (p) Distributing is an S corporation (within the meaning of §1361(a)). Controlled will elect to be an S corporation pursuant to §1362(a) 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 on the representations set forth above, it is held as follows:

- (1) The transfer by Distributing to Controlled of the assets relating to business n solely in exchange for all the stock of Controlled, as described above, followed by the distribution of all of the Controlled stock to Shareholder A in exchange for Distributing stock of equal value 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) Distributing will recognize no gain or loss upon the transfer of assets to Controlled in exchange for Controlled stock, as described above. Section 361(a).
- (3) Controlled will recognize no gain or loss on the receipt of assets relating to business n in exchange for Controlled stock. Section 1032(a).
- (4) The basis of each asset received by Controlled will be the same as the basis of that asset in the hands of Distributing immediately prior to the transaction. Section 362(b).
- (5) The holding period of the assets received by Controlled will include the period during which these assets were held by Distributing. Section 1223(2).
- (6) Shareholder A will not recognize gain or loss (and no amount will be included in the income of Shareholder A) upon receipt of the Controlled stock in exchange for Distributing stock of equal value, as described above. Section 355(a)(1).

PLR-130025-03

- (7) No gain or loss will be recognized by Distributing upon the distribution of all of its Controlled stock, as described above. Section 361(c)(1).
- (8) The basis of the stock of Controlled and Distributing in the hands of Shareholder A after the distribution will be the same as the aggregate basis of the Distributing stock held immediately before the distribution, allocated in proportion to the fair market value of each in accordance with §1.358-2(a)(2) of the Income Tax Regulations. Section 358(b)(2).
- (9) The holding period of the Controlled stock received by Shareholder A will include the holding period of the Distributing stock surrendered in exchange therefore, provided the Distributing stock is held as a capital asset on the date of the exchange. Section 1223(1).
- (10) As provided in §312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under §1.312-10(a).

Except as specifically set forth above, we express no opinion concerning the tax consequences of the proposed transaction under any other provision of the Code or regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction.

The rulings contained in this letter are based upon the facts and representations submitted by the taxpayers and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for a ruling. Verification of the information, representations, and other data may be required as part of the audit process. See section 12.04 and 12.05 of Rev. Proc. 2003-1, 2003-1 I.R.B. 1, 44, which discuss in greater detail the revocation or modification of ruling letters. However, when the criteria in section 12.06 of Rev. Proc. 2003-1, 2003-1 I.R.B. 1, 45, are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

This ruling is directed only to the taxpayer(s) 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 should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

PLR-130025-03

Sincerely,

*Ken Cohen*

Ken Cohen  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Corporate)

PLR-130025-03

cc: