

Internal Revenue Service

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Date October 31, 2003:

LEGEND

Distributing =

Controlled-1 =

Controlled-2 =

Controlled-3 =

Controlled-4 =

Controlled-5 =

Controlled-6 =

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A =

B =

C =

D =

E =

F =

G =

H =

b =c =d% =

Date 1 =

Dear

This letter responds to your letter, dated August 7, 2003, requesting rulings under sections 368 and 355 of the Internal Revenue Code (the "Code"). Additional information was submitted in a letter dated October 24, 2003. The information submitted is summarized below.

Distributing is a cash basis corporation. Currently, Distributing has outstanding c shares of stock. Individual shareholders C, D, E, F, G and H each own b shares (d%) of Distributing's sole common class of stock. C, D, E, F, G and H are the sons of A. On Date 1, Distributing redeemed all of its stock owned by A and B, the estate of A's deceased spouse.

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The taxpayer has supplied financial information that indicates that Distributing has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Each of A's sons has divergent views as to the current operations and future direction of Distributing, which have adversely affected its business operations. To address this problem and to allow each son to concentrate on running his own business, the parties have devised the following plan:

- 1) Distributing will contribute approximately d% of its assets to Controlled-1 in exchange for all of the Controlled-1 stock, and then distribute all of the Controlled-1 stock to C in exchange for all of his Distributing stock.
- 2) Distributing will contribute approximately d% of its assets to Controlled-2 in exchange for all of the Controlled-2 stock, and then distribute all of the Controlled-2 stock to D in exchange for all of his Distributing stock.
- 3) Distributing will contribute approximately d% of its assets to Controlled-3 in exchange for all of the Controlled-3 stock, and then distribute all of the Controlled-3 stock to E in exchange for all of his Distributing stock.
- 4) Distributing will contribute approximately d% of its assets to Controlled-4 in exchange for all of the Controlled-4 stock, and then distribute all of the Controlled-4 stock to F in exchange for all of his Distributing stock.
- 5) Distributing will contribute approximately d% of its assets to Controlled-5 in exchange for all of the Controlled-5 stock, and then distribute all of the Controlled-5 stock to G in exchange for all of his Distributing stock.
- 6) Distributing will contribute approximately d% of its assets to Controlled-6 in exchange for all of the Controlled-6 stock, and then distribute all of the Controlled-6 stock to H in exchange for all of his Distributing stock.
- 7) Following these exchanges (collectively, the "Exchange"), Distributing will completely liquidate.
- 8) Each Controlled corporation will be on the cash method of accounting.

The following representations have been made in connection with each of the proposed exchanges described above:

- (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 plus the liabilities to which the transferred assets are subject (as determined under section 357(d)).

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- (b) The liabilities assumed by Controlled in the transaction and the liabilities to which the transferred assets are subject (as determined under section 357(d)) were incurred in the ordinary course of business and are associated with the assets being transferred.
- (c) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the Exchange.
- (d) No intercorporate debt will exist between Distributing and Controlled at the time of the Exchange.
- (e) Payments made in connection with any transaction 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.
- (f) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (g) 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.
- (h) 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 the Distributing stock surrendered by the shareholder in the exchange.
- (i) 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.
- (j) The gross assets of the portion of Distributing's business to be conducted by Controlled immediately after the Exchange will have a fair market value that is greater than five percent of the total fair market value of Controlled's gross assets at that time.
- (k) Following the Exchange, Controlled 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 prior to the consummation of the transaction.
- (l) The Exchange of Controlled stock is primarily carried out for the following corporate business purpose: to eliminate the adverse effects on day-to-day operations of the disputes which have arisen and are expected to arise in the future between members of the family regarding matters of corporate policy and

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decision making. The Exchange is motivated, in whole or substantial part, by this corporate business purpose.

- (m) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift or otherwise dispose of any stock in, or securities of, Controlled after the Exchange.
- (n) There is no plan or intention by Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Exchange, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (o) There is no plan or intention to liquidate Controlled, to merge Controlled with any other corporation, or to sell or otherwise dispose of the assets of Controlled after the Exchange, except in the ordinary course of business.
- (p) For purposes of section 355(d), immediately after the Exchange, no person or persons (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote 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 Exchange 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 Exchange.
- (q) The Exchange 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 Controlled, entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of Controlled.
- (r) Distributing is an S corporation (within the meaning of section 1361(a)). 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 intent to revoke or terminate the S corporation election of either Distributing or Controlled.

Based solely on the information submitted and the representations made, we have concluded in the case of each exchange that:

- 1 The contribution by Distributing of certain specified properties to Controlled in exchange for all of the Controlled voting common stock and the assumption by Controlled of the associated liabilities, followed by the non-pro rata distribution by Distributing of all of the Controlled stock to a shareholder of Distributing in

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exchange for all of that shareholder's Distributing stock in complete liquidation of Distributing, 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 all of the 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 all of the shares of Controlled stock. Section 1032(a).
- 4 Controlled's basis in the assets received from Distributing will equal the basis of such assets 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 Exchange of the stock in Controlled to a shareholder of Distributing in complete liquidation of Distributing. Section 361(c)(1).
- 7 No gain or loss will be recognized to (and no amounts will be included in the income of) a shareholder of Distributing upon its receipt of Controlled stock. Section 355(a)(1).
- 8 The basis of the Controlled stock in the hands of a shareholder of Distributing 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 a shareholder of Distributing 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 Exchange. Section 1223(1).
- 10 Proper allocation of earnings and profits among the Controlled corporations will be made in accordance with section 312(h) and Treas. Reg. § 1.312-10(a).

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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.

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.

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

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

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)

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cc: