

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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January 12, 2000

Distributing =

EIN

Controlled =

State N =

Business A =

Business B =

X =

Y =

Z =

W =

A =

B =

C =

D =

E =

We reply to your letter dated August 18, 1999, in which you requested rulings as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated November 4, 1999, and January 5, 2000.

The information submitted for consideration is substantially as set forth below.

Distributing is a State N corporation engaged in Business A and Business B. Distributing has outstanding X shares of voting common stock that are owned in equal parts by five siblings (A, B, C, D, and E).

Controlled will be a State N corporation formed to effectuate the proposed transaction. Controlled will have issued and outstanding Y shares of voting common stock, all of which initially will be held by Distributing.

Financial information has been received which indicates that Distributing has had gross receipts and operating expenses representative of the active conduct of each of Business A and Business B for each of the past five years.

Because of management disagreements, Group A (A and B) and Group B (C, D, and E) have decided to divide Distributing's Business A and Business B assets and go their separate ways. Accordingly, they propose the following transaction:

- (i) Distributing will transfer to the newly-formed Controlled approximately Z percent of its business assets, plus cash. In exchange, Distributing will receive all of the issued and outstanding shares of Controlled voting common stock. Controlled will not be assuming any liabilities or receiving assets subject to liabilities from Distributing.
- (ii) Thereafter, Distributing will distribute W shares of Controlled stock to each of C, D, and E in exchange for all of their shares of Distributing stock.

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) The fair market value of the stock of Controlled received by each member of Group B, described in step (ii) above, will approximately equal the fair market value of the Distributing stock surrendered by each member of Group B in the exchange.
- (b) No part of the consideration to be distributed by Distributing is being received by a shareholder as a creditor, employee, or in any capacity other than as a shareholder of the corporation.
- (c) The five years of financial information submitted on behalf of Distributing is representative of the corporation's 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, independently and with their separate employees, the active conduct of the businesses previously conducted solely by Distributing.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purpose: management disagreements between shareholders which have an unfavorable effect on the operations of Distributing. The distribution of the stock of Controlled is motivated in whole by this corporate business purpose.
- (f) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in Distributing or Controlled subsequent to the transaction.
- (g) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of section 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 subsequent to the transaction, except in the ordinary course of business.
- (i) No investment tax credit determined under § 46 of the Internal Revenue Code has been or will be claimed with respect to the transfer of any property.
- (j) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of or subsequent to the proposed distribution.
- (l) There are no continuing transactions contemplated between Distributing and Controlled. However, any 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 is not an S corporation within the meaning of § 1361(a), and

there is no plan or intention by either Distributing or Controlled to make an S corporation election pursuant to § 1362(a).

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

- (1) The transfer by Distributing to Controlled of the assets and cash, as described in step (i) above, solely in exchange for all of the outstanding stock of Controlled, followed by the distributing of the Controlled stock by Distributing to the members of Group B in exchange for all of their Distributing stock will be a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled each will 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 and cash to Controlled in exchange for Controlled stock (§ 361(a)).
- (3) Controlled will recognize no gain or loss on the receipt of the assets and cash in exchange for the Controlled stock (§ 1032(a)).
- (4) Controlled’s basis in the assets received will be the same as the basis of such assets in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (5) Controlled’s holding period for the assets received from Distributing will include the period during which such assets were held by Distributing (§ 1223(2)).
- (6) Distributing will recognize no gain or loss upon the distribution of all of its Controlled stock to the members of Group B in exchange for their Distributing stock (§ 361(c)(1)).
- (7) The members of Group B will recognize no gain or loss (and no amount will be included in their incomes) upon the receipt of the Controlled stock in exchange for all of their shares of Distributing stock (§ 355 (a)(1)).
- (8) Each Group B member’s basis in the Controlled stock after the distribution will be the same as each group member’s basis in the Distributing stock surrendered exchange therefor (§ 358(a)(1)).
- (9) Each Group B member’s holding period in the Controlled stock received will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset by each shareholder on the date of the exchange (§ 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) of the Income Tax Regulations.

We express no opinion about the tax treatment of the transaction under other provisions of the Code and regulations or about 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.

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.

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.

Pursuant to a power of attorney on file in this office, a copy of this letter has been sent to your authorized representative.

Sincerely,
Assistant Chief Counsel (Corporate)
By: Filiz A. Serbes
Assistant to the Chief, Branch 5