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Department of the Treasury

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Distributing =

Controlled =

Target =

A =

Business 1 =

Business 2 =

a =

This letter responds to your November 3, 1999 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that letter and in later correspondence is summarized below.

Summary of Facts

Distributing is a domestic corporation engaged in Business 1 and Business 2. Financial information has been submitted indicating that Business 1 and Business 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.

Distributing wishes to expand Business 2 by acquiring unrelated Target, a domestic corporation also engaged in Business 2. However, the sole shareholder of Target, A, refuses to allow the acquisition unless Distributing's Business 2

operations are conducted by a corporation unaffiliated with Distributing.

Proposed Transaction

To accommodate A's wishes, Distributing has proposed the following transaction:

- (i) Distributing will transfer its Business 2 assets to newly formed domestic Controlled in exchange for Controlled stock and the assumption by Controlled of liabilities associated with the Business 2 assets (the "Contribution").
- (ii) Distributing will distribute the Controlled stock to its shareholders, pro rata (the "Distribution").
- (iii) Within one year following the Distribution, Target will merge into Controlled under applicable state law in a transaction intended to qualify as a reorganization under § 368(a)(1)(A) of the Internal Revenue Code (the "Merger"). Controlled will issue a percent of its stock to A in the Merger.

Representations

The taxpayer has submitted the following representations concerning the proposed transaction:

- (a) No part of the consideration 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.
- (b) The five years of financial information submitted on behalf of each of Distributing's businesses represents the present operations of these businesses, and there have been no substantial operational changes to these businesses since the date of the last submitted financial statements.
- (c) Following the proposed transaction, Distributing and Controlled each will continue the active conduct of its business, independently and with its separate employees, except for sharing certain employee services for a limited period of time.
- (d) The Distribution will facilitate the Merger. The Distribution is

motivated, in whole or substantial part, by this corporate business purpose.

(e) 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 proposed transaction.

(f) 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 proposed transaction. In connection with the Merger, Controlled, Target, and A will enter into an employment contract and shareholders' agreement having customary terms that will allow Controlled to repurchase A's Controlled stock on the termination of A's employment. Neither A nor Controlled has any plan or intention to terminate A's employment with Controlled after the Merger.

(g) 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 proposed transaction, except in the ordinary course of business and the Merger.

(h) The total adjusted basis and fair market value of the assets transferred to Controlled by Distributing will each equal or exceed the liabilities assumed (within the meaning of § 357(d)) by Controlled.

(i) The liabilities of Distributing assumed (within the meaning of § 357(d)) by Controlled will have been incurred in the ordinary course of business and are associated with the assets being transferred.

(j) The proposed transaction 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 Distributing or Controlled stock entitled to vote, or 50 percent or more of the total value of all shares of all classes of Distributing or Controlled stock.

(k) 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.

(l) 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 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 § 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.

(m) Distributing is not an S corporation (under § 1361(a)), and there is no plan or intention for Distributing or Controlled to make an S election under § 1362(a) after the proposed transaction.

(n) The income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.

(o) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.

(p) No two parties to the proposed transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(q) Payments made in connection with all continuing transactions 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.

Rulings

Based solely on the facts submitted and representations made, we rule as follows regarding the proposed transaction described above:

(1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under § 368(b).

(2) No gain or loss will be recognized by Distributing on the Contribution (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).

(4) The basis of each asset received by Controlled will equal the basis of that asset in the hands of Distributing immediately before its transfer (§ 362(b)).

(5) The holding period of each asset received by Controlled will include the period during which Distributing held that asset (§ 1223(2)).

(6) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholders upon their receipt of Controlled stock in the Distribution (§ 355(a)(1)).

(7) The aggregate basis of the Distributing stock and the Controlled stock in the hands of each Distributing shareholder will equal the aggregate basis of the Distributing stock held by that shareholder immediately before the Distribution, allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a) (§ 358(a)(1), (b), and (c)).

(8) The holding period of the Controlled stock received by each Distributing shareholder in the Distribution will include the holding period of the Distributing stock on which the Distribution is made, provided the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(9) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)).

(10) As provided in § 312(h), proper allocation of earnings and profits among Distributing and Controlled will be made under § 1.312-10(a) 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 concerning whether the Merger will qualify as a reorganization.

Procedural Statements

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

Each taxpayer affected by the proposed transaction should attach a copy of this ruling letter to its, his, or her federal tax return for the taxable year in which the proposed transaction is completed.

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

Sincerely,
Assistant Chief Counsel (Corporate)
By: Wayne T. Murray
Senior Technician/Reviewer
Branch 4