

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date:

February 13, 2004

LEGEND:

Distributing =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Shareholder 6 =

State A =

State B =

Date 1 =

Date 2 =

Date 3 =
Business D =
Business E =
F =
G =
H =
I =
J =
K =
L =
M =
N =

Dear

This is in reply to your letter requesting rulings about the transaction described in this letter. The information submitted for consideration is substantially as set forth below.

Distributing was incorporated in State A on Date 1. On Date 2, it elected to be taxed as a Subchapter S corporation and on date 3 it registered with the Office of the Secretary of State B to conduct business as a foreign corporation in State B. Distributing is engaged in Business D in State A and Business E in State B.

Distributing only has one class of stock outstanding. Shareholder 1 and Shareholder 2 each own H% of Distributing, Shareholder 3 and Shareholder 4 each own I% of Distributing and Shareholder 5 and Shareholder 6 each own J% of Distributing. Shareholder 1 and Shareholder 2 are husband and wife (The Parents) and are the parents of Shareholder 3, Shareholder 4, Shareholder 5 and Shareholder 6 (The Children). Shareholder 3 and her husband are also the sole shareholders in a

Corporation engaged in Business D that is located on land adjacent to the land where Distributing engages in Business D.

The children do not agree with the way the Parents have been operating and managing Distributing. Business E has not been profitable and Shareholder 1 has used money from Business D to supplement the losses and cash flow needs of Business E. The Children also own a separate corporation engaged in Business D. The husband of Shareholder 5 strongly believes that Business E does not have good prospects for future profitability and he further believes that Business D should not subsidize Business E. He also believes that the land in State B on which business E is conducted could be put to more profitable use. Shareholder 1 disagrees. Although the disagreements have not yet led to legal disputes, Shareholder 1 and Shareholder 2 are concerned that in the long run, the disagreements will lead to greater family problems and to legal actions. In addition, the Parents have certain estate planning goals that they wish to accomplish with respect to Business D.

To accomplish these objectives, the following transaction is proposed:

- (i) Shareholder 1 and Shareholder 2 plan to each gift to Shareholder 5 and to Shareholder 6 sufficient stock to equalize the percentage of ownership of Distributing among their children at I%. These gifts will reduce the ownership of Shareholder 1 and Shareholder 2 in Distributing to K%.
- (ii) Distributing will organize under the laws of State A two wholly owned subsidiaries, Controlled 1 and Controlled 2, by transferring L acres of real property in State A and some property used in Business D to Controlled 1 and M acres of real property in State A to Controlled 2 in exchange for L shares of the stock of Controlled 1 and N shares of the stock of Controlled 2. Distributing will contribute cash only if necessary to equalize the fair market value of the assets of Controlled 1 and Controlled 2.
- (iii) Shareholder 3 will transfer all of her stock of Distributing for all L shares of the stock of Controlled 1. It is possible that Shareholder 3 will then merge Controlled 1 into the already existing corporation that she and her husband own
- (iv) Shareholder 4, Shareholder 5, and Shareholder 6 will each exchange all of their stock in Distributing in for L shares of stock of Controlled 2, which in total is all N shares of the Controlled 2 stock.
- (v) Following the transaction, Shareholder 1 and Shareholder 2 will own 100% of the stock of Distributing, Shareholder 3 would own 100% of the stock of Controlled 1 and Shareholder 4, Shareholder 5, and Shareholder 6 will each own 33.33% of Controlled 2.

In connection with the proposed transaction, Distributing has made the following representations:

- (a) The fair market value of Controlled 1 stock and any other consideration received by Shareholder 3 will be approximately equal to the fair market value of Distributing stock surrendered by the shareholder in the exchange.
- (b) The fair market value of Controlled 2 stock and any other consideration received by Shareholders 4, 5, and 6, will be approximately equal to the fair market value of Distributing stock surrendered by each of Shareholders 4, 5, and 6 in the exchange.
- (c) No part of the consideration distributed by Distributing is being received by any of Shareholder 3, 4, 5, or 6 as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (d) The five years of financial information submitted on behalf of Distributing is representative of present operations, and with regard to such corporation there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the transaction, Distributing, Controlled 1, and Controlled 2 will each continue, the active conduct of its business independently and with separate employees.
- (f) The distribution of the stock of Controlled 1 and Controlled 2 is carried out to promote family and management harmony and avoid significant disagreements between the shareholders of Distributing concerning the management and operation of Business D and Business E. The current minority shareholders of Distributing will be able to manage their respective corporations as they see fit. The distribution of the stock, or stock and securities, of Controlled 1 and Controlled 2 is motivated in whole or substantial part by one or more of these corporate business purposes.
- (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, Controlled 1, or Controlled 2 after the transaction except for the possible merger of Controlled 1 into the corporation that Shareholder 3 and her husband own as described in (iii) above.
- (h) There is no plan or intention by either Distributing, Controlled 1, or Controlled 2, 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 section 4.05(1)(b) of Rev. Proc. 96-30.

- (i) There is no plan or intention to liquidate either Distributing, Controlled 1, or Controlled 2, to merge either corporation with any other corporation (except for the possible merger of Controlled 1 as described in (iii) above) or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (j) The assets transferred to Controlled 1 and Controlled 2 by Distributing will not be subject to any liabilities and neither Controlled 1 nor Controlled 2 will assume any liabilities of Distributing in connection with the proposed transaction.
- (k) No property is being transferred between Distributing and Controlled 1 and Controlled 2 that would be subject to investment credit recapture.
- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (m) No intercorporate debt will exist between Distributing and Controlled 1 or Controlled 2 at the time of, or subsequent to, the distribution of the stock of Controlled 1 and Controlled 2.
- (n) Payments made in connection with continuing transactions, if any, between Distributing, controlled 1 and Controlled 2 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's-length
- (o) No two parties to the transaction are investment companies as defined in Code section 368(a)(2)(F)(iii) and (iv).
- (p) For purposes of Code section 355(d), immediately after the Distribution, no person (determined after applying Code section 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 Code section 355(d)(5) and (8)) during the five year period (determined after applying Code section 355(d)(6)) ending on the date of the distribution.
- (q) For purposes of Code section 355(d), immediately after the distribution, no person (determined after applying Code section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all

classes of Controlled 1 or Controlled 2 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled 1 or Controlled 2 stock, that was either: (i) acquired by purchase (as defined in Code section 355(d)(5) and (8)) during the five year period (determined after applying Code section 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 Code section 355(d)(5) and (8)) during the five year period (determined after applying Code section 355(d)(6)) ending on the date of the distribution.

- (r) The Distribution is not part of a plan or series of related transactions (within the meaning of Code 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 either Distributing, Controlled 1, or Controlled 2 or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing, Controlled 1, or Controlled 2.
- (s) The gross assets of the portion of the business directly conducted by Distributing immediately after the distribution will have a fair market value that is greater than 5 percent of the total fair market value of Distributing's gross assets at that time.
- (t) The gross assets of the portion of the business to be conducted by Controlled 1 and Controlled 2 immediately after the distribution will have a fair market value that is greater than 5 percent of the total fair market value of Controlled 1 and Controlled 2's gross assets at that time.

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

- (1) The transfer by Distributing to Controlled 1 of assets relating to Business D solely in exchange for all of the outstanding stock of Controlled 1, followed by the distribution of all of the Controlled 1 stock to Shareholder 3 in exchange for Distributing stock as described above, will be a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled will each be a "party to a reorganization" within the meaning of section 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of assets to Controlled 1 in exchange for Controlled 1 stock as described in (ii) above. Section 361(a).

- (3) Distributing will recognize no gain or loss upon the transfer of assets to Controlled 2 in exchange for Controlled 2 stock as described in (ii) above. Section 361(a).
- (4) Controlled 1 will recognize no gain or loss on the receipt of the assets of Distributing in exchange for all of the shares of Controlled 1. Section 1032(a).
- (5) Controlled 2 will recognize no gain or loss on the receipt of the assets of Distributing in exchange for all of the shares of Controlled 2. Section 1032(a).
- (6) The basis of each asset received by Controlled 1 and Controlled 2 respectively will be the same as the basis of such assets in the hands of Distributing immediately prior to the proposed transaction. Section 362(b)
- (7) The holding period of the assets received by Controlled 1 and Controlled 2 from Distributing will include the period during which such assets were held by Distributing. Section 1223(2).
- (8) Distributing will recognize no gain or loss upon the distribution of all its Controlled 1 stock to Shareholder 3 and all of its Controlled 2 stock to Shareholder 4, 5, and 6. Section 361(c).
- (9) Shareholder 3 will not recognize gain or loss (and no amount will be included in the income of Shareholder 3) upon the receipt of Controlled 1 stock in exchange for Distributing stock of equal value as described above. Section 355(a)(1).
- (10) Shareholders 4, 5, and 6 will not recognize gain or loss (and no amount will be included in the income of Shareholder 4, 5, or 6) upon the receipt of Controlled 2 stock in exchange for all of their Distributing stock of equal value as described above. Section 355(a)(1).
- (11) The basis in the stock of Controlled 1 to be received by Shareholder 3 will be the same as the basis of the Distributing stock surrendered by her in the exchange. Section 358(a).
- (12) The holding period of the Controlled 1 stock received by Shareholder 3 will include the holding period of the Distributing stock surrendered in exchange therefore, provided that the Distributing stock was held as a capital asset by Shareholder 3 on the date of the exchange. Section 1223(1).
- (13) The basis in the stock of Controlled 2 to be received by Shareholders 4, 5

and 6 will be the same as the basis of the Distributing stock surrendered by each of them in the exchange. Section 358(a).

- (14) The holding period of the Controlled 2 stock received by Shareholders 4, 5, and 6 will include the holding period of the Distributing stock surrendered in exchange therefore, provided that the Distributing stock was held as a capital asset by each on the date of the exchange. Section 1223(1).
- (15) As provided in section 312(h) of the Code, proper allocation of earnings and profits between Distributing, Controlled 1, and Controlled 2 will be made in accordance with Treas. Reg. Section 1.312-10(a).

No opinion is expressed about the tax treatment of the proposed 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(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.

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,

Gerald B. Fleming

Gerald B. Fleming
Senior Technician Reviewer
Office of Associate Chief Counsel
(Corporate)