

Internal Revenue Service

Department of the Treasury

Number: **200252072**

Washington, DC 20224

Release Date: 12/27/2002

Index Number: 0368.04-00, 0355.01-01

Person to Contact:

Telephone Number:

(202) 622-7790

Refer Reply To:

CC:CORP:B03-PLR-131650-02

Date:

September 23, 2002

Distributing =

Controlled =

State N =

A =

B =

C =

D =

E =

F =

g =

h =

i =

PLR-131650-02

j =k =

Business Y =

Year 1 =

l =m =n =o =p =q =

Dear :

We respond to your letter dated June 3, 2002, requesting rulings on the federal income tax consequences of a proposed and partially completed transaction. Additional information has been received in a letter dated September 6, 2002. The information submitted for consideration is summarized below.

Distributing, a State N corporation, is an accrual basis corporation and is family-owned and operated. Distributing has one class of stock, voting common stock, of which q shares are issued and outstanding and are owned as follows:

Shareholder	Number of Shares
A	<u>h</u>
B	<u>i</u>
C	<u>i</u>
D	<u>i</u>
E	<u>i</u>
F	<u>k</u>

Controlled is a State N corporation formed to effectuate the transaction.

PLR-131650-02

Distributing has been engaged in Business Y since Year 1. Distributing has provided financial information that indicates that Distributing has had gross receipts and operating expenses representative of the active conduct of Business Y for the past 5 years.

Due to disagreements over the management, operation, and growth of Business Y, centering mainly on F, the Distributing shareholders have decided to vertically divide Distributing's Business Y, including certain business assets and liabilities, and go their separate ways. Accordingly, they propose the following transactions (some of which have already taken place):

- (i) Distributing transferred to Controlled approximately l percent of the net assets (assets and liabilities) and a proportionate share of the business of Distributing in exchange for all of Controlled's voting common stock (m shares) and Controlled's assumption of liabilities;
- (ii) Distributing will distribute all of these shares of Controlled stock as follows: (a) n shares to A in exchange for q shares of Distributing stock and (b) o shares to F in exchange for all k shares of Distributing stock held by F;
- (iii) Subsequent to the proposed transaction, A and F jointly will own all m shares of Controlled stock, F will own no shares of Distributing stock, and A will continue to own p shares of Distributing stock. A will not have any day-to-day operational duties in either Distributing or Controlled, though he will serve on the boards of directors of both companies. A's estate plan provides that A's ownership interests in Distributing and in Controlled will remain separated, such that F will not inherit from A any interest in Distributing and other Distributing shareholders will not inherit from A any interest in Controlled.

The taxpayers have made the following representations in connection with the proposed transaction:

- (a) The fair market value of the stock of Controlled received by each of A and F will be approximately equal to the fair market value of the Distributing stock to be surrendered by each of A and F 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 5 years of financial information submitted on behalf of Distributing is representative of the corporation's present operations, and, with regard to such corporation, there have been no substantial operational changes

PLR-131650-02

since the date of the last financial statement submitted.

- (d) Following the transaction, Distributing and Controlled each will continue, independently and with its separate employees, except for a brief transition period, the active conduct of its share of all of the integrated activities of Business Y conducted by Distributing prior to the consummation of the transaction.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purposes: to resolve shareholder, board member and management conflicts and to accommodate different goals and business techniques. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing or Controlled to make an S corporation election pursuant to § 1362(a).
- (g) 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 either Distributing or Controlled after the transaction.
- (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 section 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 after the transaction, except in the ordinary course of business.
- (j) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under § 357(d)) by Controlled. The liabilities assumed (as determined under § 357(d)) in the transaction were incurred in the ordinary course of business and are associated with the transferred assets.
- (k) No property was transferred between Distributing and Controlled upon which any investment credit determined under § 46 has been or will be claimed.

PLR-131650-02

- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (m) There are no continuing, planned, or intended transactions between Distributing and Controlled following the distribution. Any payments made in connection with all continuing transactions, if any, will be for fair market value based on the 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) or (iv).
- (o) The distribution 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 stock entitled to vote or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.

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

- (1) The transfer by Distributing to Controlled of assets in exchange for the stock of Controlled and the assumption of liabilities, as described above, followed by the distribution of all of the stock of Controlled to A and F in exchange for stock of Distributing owned by A and F will qualify as 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 to Controlled in exchange for the stock of Controlled and the assumption of liabilities (§§ 361(a) and 357(a)).
- (3) Controlled will recognize no gain or loss upon the receipt of Distributing assets in exchange for the stock of Controlled (§ 1032).
- (4) Controlled's basis of the assets received from Distributing will be the same as the basis of such assets in the hands of Distributing immediately before their transfer to Controlled (§ 362(b)).
- (5) Controlled's holding period of the transferred assets will include the period during which such assets were held by Distributing (§ 1223(2)).

PLR-131650-02

- (6) Distributing will recognize no gain or loss upon the distribution of all of the stock of Controlled to A and F in exchange for stock in Distributing (§ 361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) A or F upon receipt of the Controlled stock in exchange for Distributing stock (§ 355(a)(1)).
- (8) The basis of the Controlled stock in the hands of each of A and F will be the same as the basis of the Distributing stock surrendered by each of them in exchange therefor (§ 358(a)(1)).
- (9) The holding period of the Controlled stock received by each of A and F will include the holding period of the Distributing stock surrendered by each of them, provided such stock is held as a capital asset on the date of the transaction (§ 1223(1)).
- (10) As provided in § 312(h), following the distribution of the stock of Controlled, proper allocation of earnings and profits will be made between Distributing and Controlled in accordance with § 1.312-10(a) of the Income Tax Regulations.

We express no opinion 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.

The ruling contained in this letter is predicted 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.

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.

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

PLR-131650-02

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to the taxpayer's other authorized representative and officer.

Sincerely yours,

Filiz A. Serbes

Filiz A. Serbes
Chief, Branch 3
Office of the Associate Chief Counsel
(Corporate)