

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

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CC: Corp:B06-PLR-124183-02

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### LEGEND

Distributing =

Controlled =

State A =

Year 1 =

Business A =

Business B =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Shareholder F =

Shareholder G =

Shareholder H =

i =

j =

k =

L% =

m =

n% =

o =

p% =

q =

r% =

s =

t% =

u =

v% =

w =

x% =

y =

z% =

aa =

bb% =

cc =

dd% =

ee =

Dear

This is in response to a letter dated January 28, 2002, submitted on your behalf by your authorized representative, requesting rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated June 5, 2002, June 18, 2002, July 15, 2002 and July 22, 2002. The information submitted for our consideration is summarized below.

#### SUMMARY OF FACTS

Distributing, a calendar year taxpayer operating on the cash method of accounting, is a State A corporation that was incorporated in Year 1. Distributing is engaged in Business A and Business B.

Distributing has two classes of stock authorized and issued: non-voting common stock ("Class A Stock") and voting common stock ("Class B Stock"). Distributing has issued and outstanding i shares of Class A Stock and j shares of Class B Stock.

Issued and outstanding Class A Stock is owned by Shareholder A (k shares representing L% of outstanding Class A Stock), Shareholder B (m shares representing n% of outstanding Class A Stock), Shareholder C (m shares representing n% of outstanding Class A Stock), Shareholder D (o shares representing p% of outstanding Class A Stock), Shareholder E (q shares representing r% of outstanding Class A Stock), Shareholder F (s shares representing t% of outstanding Class A Stock), and Shareholder G (s shares representing t% of outstanding Class A Stock).

Issued and outstanding Class B Stock is owned by Shareholder A (u shares representing v% of outstanding Class B Stock), Shareholder B (w shares representing x% of outstanding Class B Stock), Shareholder C (w shares representing x% of outstanding Class B Stock), Shareholder D (y shares representing z% of outstanding Class B Stock), Shareholder E (aa shares representing bb% of outstanding Class B

Stock), and Shareholder H (cc shares representing dd% of outstanding Class A Stock).

Shareholder A and Shareholder D are siblings and are children of Shareholder H. Shareholder B and Shareholder C are children of Shareholder A. Shareholder D and Shareholder E are husband and wife and are the parents of Shareholder F and Shareholder G.

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

All activities of Distributing's Business A and Business B have been conducted by employees of Distributing, including Shareholder A and Shareholder B. Following the Distribution (defined below), all activities of Controlled's Business B will be conducted by employees of Controlled, including Shareholder D and Shareholder E.

Serious disputes and management disagreements have arisen among the shareholders that have adversely affected the business operations of Distributing. In order to alleviate the problems caused by the disputes and disagreements among the shareholders, Group A (Shareholder A, Shareholder B, Shareholder C and Shareholder H) and Group B (Shareholder D, Shareholder E, Shareholder F, and Shareholder G) have decided to go their separate ways. Accordingly, the following transaction is proposed:

- (i) Distributing will form Controlled as a wholly owned subsidiary. Controlled will be a State A corporation operating on the cash method of accounting and will have a calendar tax year. Controlled will have 1 class of stock, voting common stock, and will have ee shares outstanding.
- (ii) Distributing will transfer a portion of the assets of Business B to Controlled in exchange for all of the outstanding stock of Controlled (the "Contribution"). Controlled will neither assume any liabilities of Distributing nor receive any assets subject to liabilities in connection with the Contribution.
- (iii) Thereafter, the shareholders in Group B will exchange all of their shares of Distributing stock for all of the outstanding shares of Controlled (the "Distribution").

Immediately after the Distribution, the shareholders in Group A will collectively own 100% of the outstanding stock of Distributing, and the shareholders in Group B will collectively own 100% of the outstanding stock of Controlled.

Following the Distribution, no shareholder in Group B will be an officer or director of Distributing, and no shareholder in Group A will be an officer or director of Controlled.

## REPRESENTATIONS

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

- (a) 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.
- (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 operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Immediately after the Distribution, the gross assets of Distributing's Business A and Business B will have a fair market value of at least five percent (5%) of the total fair market value of the gross assets of Distributing.
- (e) Immediately after the Distribution, the gross assets of Controlled's Business B will have a fair market value of at least five percent (5%) of the total fair market value of the gross assets of Controlled.
- (f) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (g) The distribution of the stock of Controlled is carried out for the following corporate business purpose: management disagreements and shareholder disputes which have an unfavorable effect on the operations of Distributing. The distribution of the stock of Controlled is motivated, in whole or substantial part, by that corporate business purpose.
- (h) 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).
- (i) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, have redeemed, or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the transaction.

- (j) 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.
- (k) 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.
- (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 at the time of, or subsequent to, the distribution of the stock of the Controlled stock.
- (n) 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.
- (o) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv).
- (p) 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 (d)(8)) during the five-year period (determined after applying §355(d)(6)) ending on the distribution date.

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 distribution date, 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 distribution date.

- (q) 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 either Distributing or Controlled stock entitled to vote or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

## RULINGS

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

- (1) The Contribution followed by the Distribution will qualify as a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled will each be a “party to a reorganization” within the meaning of §368(b).
- (2) No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for stock of Controlled (§361(a)).
- (3) No gain or loss will be recognized by Controlled upon the receipt of Distributing assets in exchange for the stock of Controlled (§1032(a)).
- (4) No gain or loss will be recognized by Distributing on the Distribution (§361(c)(1)).
- (5) The basis of the assets received by Controlled in the Contribution will be the same as the basis of such assets in the hands of Distributing immediately before their transfer to Controlled (§362(b)).
- (6) The holding period of the assets transferred to Controlled in the Contribution will include the period during which such assets were held by Distributing (§1223(2)).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) any Distributing shareholders upon receipt of Controlled stock in exchange for their Distributing stock as described above (§355(a)(1)).
- (8) The basis of the Controlled stock in the hands of each of the shareholders in Group B will be the same as the basis of the Distributing stock surrendered by each of the shareholders in Group B in exchange therefor (§358(a)(1)).
- (9) The holding period of the Controlled stock received by each of the shareholders in Group B will include the holding period of the Distributing stock surrendered by each of the shareholders in Group B in exchange therefor, provided such stock is held as a capital asset on the date of the transaction (§1223(1)).
- (10) As provided in §312(h), following distribution of the stock of Controlled, proper allocation of earnings and profits will be made between Distributing and

Controlled in accordance with Treas. Reg. §1.312-10(a).

#### CAVEAT

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.

#### PROCEDURAL STATEMENTS

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.

This ruling is directed only to the taxpayer(s) requesting it. §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 the federal income tax return of each taxpayer involved in the taxable year in which the transaction is consummated.

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

Sincerely yours,

Reginald Mombrun

Reginald Mombrun

Assistant to the Branch Chief,

Office of Associate Chief Counsel  
(Corporate)

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Branch 6

cc:



