

Internal Revenue Service

Department of the Treasury

Index Number: 0355.00-00

Washington, DC 20224

Number: **199928022**

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Release Date: 7/16/1999

Telephone Number:

Refer Reply To:

CC:DOM:CORP:5 PLR-121925-98

Date:

April 5, 1999

Distributing =

Controlled =

Acquiring =

Shareholder A =

Shareholder B =

Shareholder C =

State X =

State Y =

State Z =

Business Z =

\$M =

\$N =

\$P =

R =

S =

\$T =

Dear

This is in reply to a letter dated November 30, 1998, in which rulings were requested as to the federal income tax consequences of a proposed transaction. Additional information was submitted in a letter dated February 11, 1999. The facts submitted for consideration are substantially as set forth below.

Distributing is a State X corporation which is engaged in Business Z in State X. Distributing has outstanding 200 shares of common stock which are held, as follows:

<u>Shareholder</u>	<u>No. of Shares</u>
Shareholder A	62.5
Shareholder B	62.5
Shareholder C	75
	<hr/> 200

Controlled is a State Y corporation which is engaged in Business Z in State Y. Controlled has outstanding 200 shares of common stock, all of which are held by Distributing.

Acquiring is a State Z corporation engaged in Business Z in State Z. Acquiring has outstanding 225.6 shares.

Financial information has been submitted which indicates that each of Distributing's business and Controlled's business has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the last five years.

Shareholders A and B reside in State X, where Distributing's business is located. Shareholder C resides in State Y, where Controlled's business is located. The three

shareholders have agreed that Shareholder C should go his separate way with respect to the operations of Business Z. Accordingly, the following transaction is proposed:

- (A) Distributing will contribute to Controlled's capital a debt of \$T owed by Controlled to Distributing. No liability will be assumed by Controlled in connection with the transfer.
- (B) In exchange for all of Shareholder C's stock in Distributing, Distributing will distribute to Shareholder C (i) all of the Controlled stock, (ii) \$M and (iii) a short term note for \$N ("Distributing Note").
- (C) Distributing will merge with and into a newly created subsidiary ("Sub") of Acquiring in exchange for S shares of Acquiring stock, \$N, and the assumption by Sub of the liabilities of Distributing.

In connection with the transaction, it has been represented that:

- (a) Distributing and Controlled and their respective shareholders will each pay their own expenses, if any, incurred in connection with the transaction.
- (b) The fair market value of the Controlled stock and other consideration received by Shareholder C approximately equals the fair market value of the Distributing stock surrendered by Shareholder C in the exchange.
- (c) No part of the consideration distributed by Distributing is being received by a shareholder as a creditor, employee or in any capacity other than that of a shareholder of the corporation.
- (d) Following the transaction Acquiring, as to Distributing's business acquired by Acquiring, and Controlled will each continue the active conduct of its respective business independently and with its separate employees.
- (e) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock other than the \$T debt to be cancelled pursuant to step (C) of the proposed transaction.
- (f) The five years of financial information submitted on behalf of Distributing's business and Controlled's business is, in each instance, representative of its present operations and, with regard to each such corporation, there have been no substantial operational changes since the date of the last financial statement submitted.

- (g) There is no plan or intention to liquidate Controlled, to merge Controlled with any other corporation, or to sell or otherwise dispose of the assets of Controlled subsequent to the transaction, except in the ordinary course of business.
- (h) Other than in step (C) of the proposed transaction set forth above, 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 subsequent to the distribution of Controlled. There is no plan or intention by the shareholders of Distributing to sell, exchange or otherwise dispose of any of their stock of Acquiring subsequent to the transaction.
- (i) Payments made in connection with all continuing transactions, if any, between Acquiring and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (j) There is no plan or intention by 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 § 4.05(1)(b) of Rev. Proc. 96-30.
- (k) Distributing is aware of no plan or intention on the part of Acquiring, 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 § 4.05(1)(b) of Rev. Proc. 96-30.
- (l) Neither Distributing nor Controlled will elect to be treated as an S corporation under § 1361 of the Code for federal income tax purposes.
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv) of the Code.
- (o) The merger transaction set forth above as step (C) of the proposed transaction will qualify as a reorganization pursuant to § 368(a) of the Internal Revenue Code.

Based on the information submitted and on the representations set forth above, it is held as follows:

- (1) For federal income tax purposes the transfer of the \$T debt to Controlled will be viewed as a transfer in exchange for an amount of the 200 shares of outstanding Controlled stock equivalent in value to the \$T debt transferred.

- (2) The transfer of the \$T debt in exchange for stock of Controlled, followed by the distribution of all of the Controlled stock, \$M, and the Distributing Note to Shareholder C in exchange for all of his stock of Distributing, will be 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).
- (3) No gain or loss will be recognized to Distributing upon the transfer of the \$T debt to Controlled in exchange for Controlled stock, as described above (§ 361(a)).
- (4) No gain or loss will be recognized to Controlled on receipt of the \$T debt from Distributing solely in exchange for Controlled stock (§ 1032(a)).
- (5) Gain will be recognized to Shareholder C upon the receipt of Controlled stock, \$M, and the Distributing Note in an amount not in excess of the \$M and the fair market value of the Distributing Note (§ 355(a)(1) and § 356(a)(1)). The gain shall be treated as gain from the exchange of property.
- (6) Gain will be recognized to Distributing upon the distribution of the Controlled stock, \$M, and the Distributing note as if such property were sold to Shareholder C at its fair market value (§ 361(c)(1) and § 355(e)).
- (7) The basis of the Controlled stock distributed to Shareholder C shall be the same as the Distributing stock exchanged therefor decreased by the fair market value of the Distributing Note and the \$M amount, and increased by the amount of gain which was recognized on such exchange (§ 358(a)(1)).
- (8) The holding period of the Controlled stock will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset on the date of the exchange (§ 1223(1)).
- (9) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 1.312-10(a) of the regulations.

No opinion is expressed as to whether § 357(b) applies to the assumption by Acquiring of the Distributing Note. Furthermore, no opinion is expressed 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 transaction that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) 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.

In accordance with the power of attorney on file in this office, we have sent a copy of this letter to the taxpayer.

Sincerely yours,
Assistant Chief Counsel (Corporate)

By: _____
Debra Carlisle
Chief, Branch 5