

## Internal Revenue Service

## Department of the Treasury

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Date:  
June 7, 2000

### Legend

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Business A =

State A =

State B =

Date 1 =

Year 1 =

Dear

This is in response to your authorized representative's letter dated February 3, 2000, requesting rulings under § 355 of the Internal Revenue Code (the "Code") with respect to a proposed transaction. Additional information was received in a letter dated May 12, 2000. The material information submitted is summarized below.

Distributing is a State A corporation that files its federal income tax return on a calendar year basis using the accrual method of accounting. Distributing made a Subchapter S election effective Date 1. Distributing has a single class of stock outstanding. The stock of Distributing is owned 50% by Shareholder A and 50% by Shareholder B.

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Distributing is engaged in Business A. Financial information has been received indicating that Business A has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five years. In an attempt to minimize disputes between Shareholder A and Shareholder B that were adversely affecting Distributing's business, in Year 1 Distributing entered into a series of transactions that were intended to, and are represented to have, qualified under section 1031 of the Code. As a result of those transactions, Distributing, which previously had done business only in State A, owned Business A assets both in State A and in State B.

Since the transactions just described, Shareholder A, who lives in State A, has concentrated on the business in State A, and Shareholder B, who lives in State B, has concentrated on the business in State B. Nonetheless the disputes between Shareholder A and Shareholder B have continued, and have continued to affect the business of Distributing adversely. In order to eliminate the ill effects of those disputes on the business and to allow each of Shareholder A and Shareholder B to concentrate attention and effort on one geographical part of the business, Distributing proposes the following series of transactions:

1. Distributing will form a subsidiary, Controlled, and will contribute to Controlled the State B assets of Business A in exchange for 100% of the stock of Controlled and the assumption by Controlled of certain Distributing liabilities.
2. Distributing will distribute all of the stock of Controlled to Shareholder B in exchange for all of Shareholder B's Distributing stock.

Distributing has made the following representations with respect to the proposed series of transactions:

- (a) The fair market value of the 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) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior thereto.
- (d) The distribution of the stock, or stock and securities, of Controlled is carried out for the following corporate business purposes: (1) to eliminate mistrust between two equal shareholders which have resulted in disputes over management goals and practices;

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(2) to eliminate continued friction that could result in the shareholders having to end Distributing's business operations.

(e) Distributing is an S corporation within the meaning of section 1361(a). Controlled will elect to be an S corporation pursuant to section 1362(a) on the first available date after the distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

(f) 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 transaction.

(g) 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.

(h) Distributing and Controlled have no accumulated earnings and profits at the beginning of their respective taxable years.

(i) Distributing and Controlled will have no current earnings and profits as of the date of the distribution.

(j) No distribution of property by Distributing immediately before the transaction would require recognition of gain resulting in current earnings and profits for the taxable year of the distribution.

(k) Distributing is not aware of, nor is Distributing planning or intending, any event that will result in Distributing or Controlled having positive current or accumulated earnings and profits after the distribution.

(l) 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.

(m) The total adjusted bases and fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.

(n) The liabilities assumed in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

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(o) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.

(p) 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.

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

Based solely on the information provided and the representations made, we conclude as follows:

(1) The transfer of the State B business assets by Distributing to Controlled in exchange for all the stock of Controlled and the assumption of certain Distributing liabilities described above, followed by the distribution of all of the Controlled stock to Shareholder B in exchange for all of the Distributing stock owned by Shareholder B will be a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be a "party to the reorganization" within the meaning of section 368(b).

(2) No gain or loss will be recognized by Distributing upon the transfer of the State B business assets to Controlled in exchange for the Controlled stock and assumption of certain Distributing liabilities as described above.

(3) No gain or loss will be recognized by Distributing upon the transfer of assets of Controlled in exchange for the Controlled stock (section 361(a)).

(4) The basis of each of the assets to be received by Controlled in the transaction will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (section 362(b)).

(5) The holding period of each of the assets to be received by Controlled will include the period during which Distributing held such assets (section 1223(2)).

(6) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder B upon the receipt of Controlled stock in exchange for the Distributing stock held by Shareholder B (section 355(a)(1)).

(7) The basis of the Controlled stock to be received by Shareholder B will be the same as the basis of the Distributing stock surrendered in exchange therefore (section 358(a)(1)).

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(8) The holding period of the Controlled stock to be received by Shareholder B will include the holding period of the Distributing stock surrendered by Shareholder B in exchange therefor provided that the Distributing stock is held as a capital asset on the date of the exchange (section 1223(1)).

(9) Distributing's momentary ownership of the stock as part of a reorganization under section 368(a)(1)(D) will not cause Controlled to have an ineligible shareholder under section 1361(b)(1)(B). Therefore, assuming Controlled will otherwise meet the requirements of a small business corporation under section 1361 of the Code, Controlled will be eligible to make an S corporation election under section 1362(a) for its first taxable year.

(10) Controlled will be subject to section 1374 with respect to any asset transferred to Controlled from Distributing to the same extent Distributing was subject to section 1374 with respect to such asset. For purposes of section 1374, Controlled's recognition period will be reduced by the portion of Distributing's recognition period that elapses prior to Distributing's transfer of these assets to Controlled.

No opinion is expressed as to the tax treatment of the transaction under other provisions of the Code or 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 ruling. Specifically, no opinion was asked and none is expressed as to whether Distributing's S corporation election is valid or whether Controlled's intended S corporation election is valid. Additionally, no opinion was asked and none is expressed as to whether the Year 1 transactions described above qualified under section 1031 of the Code.

In accordance with a power of attorney on file in this office, copies of this letter are being sent to your authorized representatives.

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.

Sincerely yours,  
Assistant Chief Counsel (Corporate)  
By Charles M. Levy  
Counsel to the Assistant Chief Counsel (Corporate)