

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

April 20, 1999

Distributing =

Controlled =

Business A =

Group A =

Group B =

x =

y =

Dear:

This letter responds to your December 3, 1998 request for rulings on certain federal income tax consequences of a proposed transaction. The information provided in that request is summarized below.

Distributing conducts Business A and is owned x percent by Group A and y percent by Group B.

PLR-100649-99

Financial information has been submitted indicating that Distributing had gross income and operating expenses representing the conduct of an active business during each of the past five years.

The business purpose for the proposed transaction is to enable the shareholder groups to each concentrate on that aspect of the business which is of the most interest to them and to remedy the shareholders' inability to agree on the growth and continuation of the business operations. By enabling the shareholders to do this, the business currently operated by Distributing will be more efficient and profitable. By separating the current business of Distributing pursuant to the Plan of Reorganization, the assets will be better utilized and be more productive. To allow Group A and Group B to go their own ways and cause their corporations to conduct Business A in the way each Group thinks best, the following transaction has been proposed:

(i) Distributing will transfer certain Business A assets to newly formed Controlled in exchange for 100% of the issued and outstanding stock of Controlled (the "Contribution").

(ii) Distributing will distribute all of the Controlled stock to the members of Group A in exchange for all of the Distributing stock held by each member of Group A (the "Distribution").

The taxpayer has made the following representations concerning the proposed transaction:

(a) The fair market value of the Controlled stock 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 the corporation.

(c) The five 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 since the date of the last financial statements submitted.

(d) Following the Distribution, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its business.

(e) The Distribution is being carried out for the purposes set forth above. The Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.

PLR-100649-99

(f) Distributing is an S corporation (within the meaning of § 1361(a)). Controlled will elect to be an S corporation pursuant to § 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.

(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 Distribution.

(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 Distribution, other than through stock purchases meeting the requirements of § 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 Distribution, except in the ordinary course of business.

(j) (1) The total adjusted bases and the 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; and (2) the liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

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

(l) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv) of the Internal Revenue Code.

(m) 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.

(n) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the Contribution and Distribution.

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

(1) The transfer by Distributing to Controlled of certain Business A assets in exchange for all of the common stock of Controlled, followed by the distribution of all

PLR-100649-99

the Controlled stock will constitute a reorganization under § 368(a)(1)(D) of the Code. Distributing and Controlled will each be "a party to a reorganization" under § 368(b) of the Code.

(2) Distributing will recognize no gain or loss upon the transfer of certain Business A assets to Controlled in exchange for all of Controlled's stock and the assumption of liabilities, as described above (Code §§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled on receipt of the assets in exchange for all the shares of Controlled (§ 1032(a)).

(4) Controlled's basis in the Distributing assets received by Controlled in the transaction will be the same as the basis of such assets in the hands of Distributing immediately before the transfer (§ 362(b)).

(5) Controlled's holding period of the Distributing assets received by Controlled in the transaction will include the period during which Distributing held the assets (§1223(2)).

(6) No gain or loss will be recognized to (and no amount will be included in the income of) the Group A shareholders upon receipt of Controlled stock in exchange for all of their Distributing stock, as described above (§ 355(a)).

(7) The basis of the Controlled stock received by each member of Group A will be the same as the basis of the Distributing stock that member surrendered in exchange therefor (§ 358(a)(1)).

(8) The holding period of the Controlled stock to be received by the shareholders of Distributing, as described above, will include the period of the Distributing stock surrendered in the exchange, provided that such stock is held as a capital asset by those respective shareholders on the day of the exchange (§ 1223(1)).

(9) Distributing will recognize no gain or loss upon the distribution of all of its Controlled stock to Distributing shareholders, as described above, pursuant to § 311(a).

(10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a).

We express no opinion about the tax treatment of the transaction under any other section of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered in the above rulings.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of

PLR-100649-99

the Code provides that it may not be used or cited as precedent.

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.

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

Assistant Chief Counsel (Corporate)

By: _____
Lewis K Brickates
Assistant to Chief, Branch 2