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Department of the Treasury

Washington, DC 20224

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Refer Reply To:

CC:CORP:4 – PLR-132581-03

Date:

November 24, 2003

LEGEND

Distributing =

Controlled 1 =

Controlled 2 =

Shareholder A =

Shareholder B =

Shareholder C =

Debt Holder =

a =

Business X =

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Dear _____ :

This letter responds to your May 16, 2003 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in subsequent correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of these facts or representations, but such verification may be required as part of the audit process.

Summary of Facts

Distributing is a closely held corporation that has voting common stock outstanding. Shareholder A, Shareholder B, and Shareholder C each own one-third of the outstanding stock. Debt Holder owns \$a of Distributing debt securities.

Distributing conducts Business X. Distributing has submitted financial information indicating that Business X has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Distributing shareholders cannot agree on the operation and management of Business X. This disagreement is having an adverse effect on the day-to-day operation of Distributing. To resolve these continuing shareholder disputes, Distributing has decided to separate Business X as follows (the "Proposed Transaction"):

Proposed Transaction

- (i) Distributing will transfer certain Business X assets to newly formed Controlled 1 in exchange for Controlled 1 stock, Controlled 1 debt, and the assumption by Controlled 1 of the liabilities associated with Business X assets ("Contribution 1").
- (ii) Distributing will transfer certain Business X assets to newly formed Controlled 2 in exchange for Controlled 2 stock, Controlled 2 debt, and the assumption by Controlled 2 of the liabilities associated with the Business X assets ("Contribution 2") (Contribution 1 and Contribution 2, collectively, the "Contributions," and the Controlled 1 debt and the Controlled 2 debt, collectively, the "New Debt").

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- (iii) Distributing will distribute all of the Controlled 1 stock to Shareholder A in exchange for all of her Distributing stock ("Distribution 1").
- (iv) Distributing will distribute all of the Controlled 2 stock to Shareholder B in exchange for all of his Distributing stock ("Distribution 2").
- (v) Debt Holder will surrender a portion of the Distributing debt securities in exchange for the New Debt (the "Security Exchange") (Distribution 1, Distribution 2, and the Security Exchange, collectively, the "Distributions").

Representations

Distributing has made the following representations with respect to the Proposed Transaction:

(a) The fair market value of the Controlled 1 and Controlled 2 stock to be received by Shareholder A and Shareholder B, respectively, will approximately equal the fair market value of the Distributing stock surrendered by each in the exchange.

(b) No part of the consideration to be distributed by Distributing will be received by Shareholder A or Shareholder B as a creditor, employee, or in any capacity other than that of a Distributing shareholder.

(c) No part of the consideration to be distributed by Distributing will be received by Debt Holder as an employee or in any other capacity other than that of a Distributing security holder.

(d) The five 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.

(e) Following the transaction, Distributing, Controlled 1, and Controlled 2 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 before consummation of the transaction.

(f) The Distributions are carried out for the following corporate business purpose: avoiding significant existing disagreements and conflicts among the Distributing shareholders concerning business objectives. The Distributions are motivated, in whole or substantial part, by this corporate business purpose.

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(g) Distributing is not an S corporation (within the meaning of §1361(a)), and there is no plan or intention by Distributing, Controlled 1, or Controlled 2 to make an S corporation election pursuant to § 1362(a).

(h) There is no plan or intention by Shareholder A, Shareholder B, Shareholder C, or Debt Holder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, Distributing, Controlled 1, or Controlled 2 after the transaction.

(i) There is no plan or intention by Distributing, Controlled 1, or Controlled 2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distributions.

(j) There is no plan or intention to liquidate Distributing, Controlled 1, or Controlled 2, to merge any of the three corporations with any other corporation, or to sell or otherwise dispose of the assets of any of the three corporations after the transaction, except in the ordinary course of business.

(k) The total adjusted basis and the fair market value of the assets transferred to Controlled 1 by Distributing will equal or exceed the liabilities assumed by (as determined under § 357(d)) Controlled 1 plus any liabilities to which the transferred assets are subject and the total adjusted basis and fair market value of the assets to be transferred to Controlled 2 by Distributing will equal or exceed the liabilities assumed (as determined under § 357(d)) by Controlled 2 plus any liabilities to which the transferred assets are subject.

(l) The liabilities assumed (as determined under § 357(d)) 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.

(m) No investment tax credit determined under § 46 has been (or will be claimed) with respect to any property to be transferred to Controlled 1 or Controlled 2.

(n) No intercorporate debt will exist between Distributing, Controlled 1, and Controlled 2 at the time of, or after, the Distributions.

(o) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(p) Payments made in connection with all continuing transactions, if any, between Distributing, Controlled 1, and Controlled 2, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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(q) Following the Distributions, the fair market value of the gross assets of each of Distributing, Controlled 1, and Controlled 2 relied on to satisfy the active trade or business requirement of § 355(b) will have a fair market value of not less than five percent of the total fair market value of the gross assets of such corporation.

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

(s) For purposes of § 355(d), immediately after the Distributions, 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 (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distributions.

(t) For purposes of § 355(d), immediately after the Distributions, 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 1 or Controlled 2 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled 1 or Controlled 2 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 date of the Distributions 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 date of the Distributions.

(u) The Distributions are 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 Distributing, Controlled 1, or Controlled 2 stock, or stock possessing 50 percent or more of the total value of all classes of Distributing, Controlled 1, or Controlled 2 stock.

Rulings

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

(1) The Contributions, followed by the Distributions, will each be a reorganization within the meaning of § 368(a)(1)(D). Distributing, Controlled 1, and Controlled 2 each will be “a party to a reorganization” within the meaning of § 368(b).

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(2) No gain or loss will be recognized by Distributing on the Contributions (§§ 357(a) and 361(a)).

(3) No gain or loss will be recognized by Controlled 1 or Controlled 2 on the Contributions (§1032(a)).

(4) The basis of each asset received by Controlled 1 and Controlled 2 in the Contributions will equal the basis of that asset in the hands of Distributing (§ 362(b)).

(5) The holding period of each asset received by Controlled 1 and Controlled 2 in the Contributions will include the period Distributing held that asset (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing on its distribution of Controlled 1 and Controlled 2 stock in the Distributions (§ 361(c)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Shareholder A and Shareholder B upon their receipt of Controlled 1 stock and Controlled 2 stock, respectively, in exchange for their Distributing stock (§ 355(a)).

(8) The basis of the stock of Controlled 1 and Controlled 2 in the hands of Shareholder A and Shareholder B, respectively, will be the same as the basis of the Distributing stock surrendered by such shareholder in exchange therefore (§ 358(a)(1)).

(9) The holding period of Controlled 1 and Controlled 2 stock received by Shareholder A and Shareholder B, respectively, will include the holding period of the respective Distributing stock surrendered by the shareholder, provided that the Distributing stock is held as a capital asset on the date of the Distributions (§ 1223(1)).

(10) Earnings and profits will be allocated between Distributing, Controlled 1, and Controlled 2 in accordance with §§ 312(h) and 1.312-10(a).

(11) No gain or loss will be recognized by Distributing on the distribution of the New Debt (§ 361(c)).

(12) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Debt Holder on the exchange of an existing Distributing debt security that qualifies as a security under § 355(a) solely for New Debt that also qualifies as a security, provided the existing Distributing debt that is surrendered has an aggregate principal amount equal to the aggregate principal amount of the New Debt received (§ 355 (a)).

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Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations, or 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

This ruling letter is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each taxpayer involved in the Proposed Transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the Proposed Transaction is completed.

Under a power of attorney on file in this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Corporate)

cc: