

INTERNAL REVENUE SERVICE

Index number: 355.04-00

Number: **199920024**

Release Date: 5/21/1999

CC:DOM:CORP:3 PLR-120308-98

February 17, 1999

Distributing =

Controlled =

IndividualA =

Business1 =

Business2 =

Year1 =

Year2 =

StateX =

This letter replies to your letter dated October 21, 1998, requesting rulings on behalf of the above referenced taxpayer. Additional information was provided in letters dated December 16, 1998, and January 21 and February 1, 1999. The facts submitted for consideration are summarized below.

IndividualA owns all the stock of Distributing, a StateX corporation engaged in Business1. Distributing became engaged in Business2 in Year1. In Year2, Distributing formed Controlled as a StateX corporation, transferring Business2 to Controlled in exchange for all the stock of Controlled. Distributing has owned all the Controlled stock since that time. Distributing and Controlled are both calendar year, cash basis taxpayers. They do not file a

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consolidated return. Distributing and Controlled are both C corporations. Financial information has been received indicating that Distributing (and, since its inception, Controlled) had gross receipts and operating expenses for Business1 and for Business2 that are representative of the active conduct of a trade or business for each of the past five years.

Distributing has submitted information evidencing that both Business1 and Business2 present substantial risk of loss. Although Distributing and Controlled have insurance, they cannot reasonably obtain adequate insurance and the potential loss (beyond that for which they can obtain insurance) far exceeds the combined value of Distributing and Controlled. Distributing has also submitted information indicating that, under StateX law, the likelihood of claimants against one corporation reaching assets of the other corporation is significantly lessened if the corporations are held separately by an individual. Accordingly, to protect the assets of each corporation from claims against the other, Distributing proposes to distribute all the stock of Controlled to its sole shareholder, IndividualA.

Distributing has made the following representations in connection with the proposed transaction:

- (a) Indebtedness owed by Controlled to Distributing after the distribution of the Controlled stock will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Distributing will be received by IndividualA as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The five years of financial information submitted on behalf of Distributing and Controlled is representative of the corporations' present operation and, with regard to such corporations, there have been no substantial operational changes (other than BusinessB being transferred to Controlled in Year2) since the date of the last financial statements submitted.
- (d) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (e) The distribution of the stock of Controlled is carried out in order to shield both Distributing and Controlled from the risks of the other corporation. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) IndividualA has no plan or intention to sell, exchange, transfer by gift, or otherwise dispose of any of the stock or securities of either Distributing or Controlled after the transaction.

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- (g) Neither Distributing nor Controlled has any plan or intention, 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.
- (h) 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.
- (i) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (j) Other than current rent and other accounts payable resulting from the ordinary course of the trade or business, there will be no intercorporate debt existing between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (k) 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.
- (l) Neither Distributing nor Controlled intend to elect to be treated as an S corporation under § 1362(a) after the distribution.
- (m) The distribution is not part of a plan or series of related transactions (within the meaning of section 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 stock of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

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

- (1) Distributing will recognize no gain or loss upon the distribution to IndividualA of all of the Controlled stock (§ 355(c)).
- (2) No gain or loss will be recognized by, and no amount will be included in the income of, IndividualA upon receipt of the Controlled stock (§ 355(a)(1)).

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- (3) The basis of the stock of Distributing and of Controlled in the hands of IndividualA after the distribution will be the same as the aggregate basis of the Distributing stock held immediately before the distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) of the regulations (§§ 358(a), (b) and (c)).
- (4) The holding period of the Controlled stock received by IndividualA will include the holding period of the Distributing stock with respect to which the distribution will be made, provided that IndividualA holds the Distributing stock as a capital asset on the date of the distribution (§ 1223(1)).
- (5) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 1.312-10(b).

We express no opinion 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 has no effect on any earlier documents and is directed only to the taxpayer on whose behalf it was requested. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Affected taxpayers must attach a copy of this letter to their federal income tax returns for the tax 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 are sending a copy of this letter to the taxpayer.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By *Ken Cohen*

Ken Cohen

Senior Technician Reviewer, Branch 3