

## Internal Revenue Service

Department of the Treasury  
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Person To Contact:

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Date:

December 4, 2003

### Legend

Distributing =  
Controlled 1 =  
Controlled 2 =  
State X =  
Business A =  
Date 1 =  
Date 2 =  
Location 1 =  
Location 2 =  
Group 1 =  
Group 2 =

Dear :

This letter responds to your July 29, 2003 request for rulings submitted on behalf of Distributing regarding certain federal income tax consequences of a proposed transaction. Additional information was received in a letter dated September 25, 2003. The information submitted in July 29, 2003 request and in the later correspondence is summarized below.

### Summary of Facts

Distributing was incorporated on Date 1 in State X. Distributing is engaged primarily in Business A which it carries on in Location 1 and Location 2. Distributing owned a third location which was sold on Date 2 due to lack of profitability. Distributing has supplied financial information indicating that each location of Business A has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

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Distributing has one class of stock which is owned equally by the Group 1 and Group 2 shareholders. The Group 1 and Group 2 shareholders have had continuing disputes and disagreements with respect to the management and operation of Business A as conducted by Distributing. These disputes adversely affect the normal operations of the business. The shareholders of these groups have decided to engage in a split-up so that the shareholders may each go their separate way. To effect the separation, Distributing proposes the following transaction:

Controlled 1 and Controlled 2 will each be formed as State X corporations. Distributing will transfer the operating assets of Location 1 to Controlled 1 in exchange for all of its stock and the operating assets of Location 2 to Controlled 2 in exchange for all its stock. Cash will be used to equalize differences, if any, in the net values of assets transferred to Controlled 1 or Controlled 2. Distributing will exchange all of Groups 1's stock in Distributing for all of the stock of Controlled 1, and Group 2 will receive all of the stock of Controlled 2 in exchange for its Distributing stock. Distributing will liquidate after the exchanges are complete.

The following representations have been made in connection with the proposed transaction:

- (a) The fair market value of the stock of Controlled 1 and Controlled 2 to be received by the Group 1 and Group 2 shareholders will be approximately equal to the fair market value of the Distributing corporation stock surrendered by the Group 1 and Group 2 shareholders in the exchange.
- (b) No part of the consideration distributed by Distributing is being received by any shareholder as a creditor, employee, or in any capacity other than that as a shareholder of Distributing.
- (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 transaction, Controlled 1 and Controlled 2 will each continue, independently and with its separate employees, the active conduct of the business conducted by Distributing prior to the consummation of the transaction.
- (e) The distribution of the stock of Controlled 1 and Controlled 2 is carried out for the following corporate business purpose: to eliminate shareholder disputes that, if permitted to continue, would jeopardize the operation and continued success of the corporate business. By effecting a separation of ownership and management of Business A through a split-up, the Group 1 shareholders will exclusively own and

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operate Controlled 1, and the Group 2 shareholders will exclusively own and operate Controlled 2. The distribution is motivated, in whole or substantial part, by the forgoing corporate business purpose.

(f) The gross assets of the part of the business to be conducted by Controlled 1 immediately after the distribution will have a fair market value that is greater than 5 percent of the total fair market value of the gross assets of Controlled 1. The gross assets of the part of the business to be conducted by Controlled 2 immediately after the distribution will have a fair market value that is greater than 5 percent of the total fair market value of the gross assets of Controlled 2.

(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 Distributing, Controlled 1, or Controlled 2 after the transaction.

(h) There is no plan or intention by Distributing, Controlled 1, or Controlled 2, directly or indirectly 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.

(i) There is no plan or intention to liquidate Controlled 1 or Controlled 2, to merge either Controlled 1 or Controlled 2 with any corporation, or to sell or otherwise dispose of the assets of Controlled 1 or Controlled 2 after the transaction except in the ordinary course of business. Distributing will be liquidated after the transaction.

(j) The total adjusted basis and fair market value of the assets transferred to Controlled 1 and Controlled 2 respectively by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled 1 and Controlled 2, plus any liabilities to which the transferred assets are subject. The liabilities assumed in the transaction and the liabilities to which the transferred assets were subject were incurred in the ordinary course of business and are associated with the assets being transferred.

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

(l) No intercorporate debt will exist between Distributing and either Controlled corporation or between Controlled 1 and Controlled 2 at the time of, or subsequent to, the distribution of Controlled corporations' stock.

(m) There will be no continuing transactions between Controlled 1 and Controlled 2 subsequent to the separation.

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

(o) The distribution of the stock of Controlled 1 and Controlled 2 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 any of Distributing, Controlled 1 or Controlled 2 or stock possessing 50% or more of the total value of all classes of stock of any of Distributing, Controlled 1, or Controlled 2.

(p) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of either Controlled 1 or Controlled 2 stock that was either (i) acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

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

1. The transfer of the Distributing assets to Controlled 1 and Controlled 2 in exchange for all of the stock of the Controlled corporations followed by the distribution of the stock of Controlled 1 and Controlled 2 to the Group 1 and Group 2 shareholders, respectively, in exchange for the stock in Distributing owned by those shareholders will be a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and both Controlled corporations will each be "a party to the reorganization" within the meaning of section 368(b) of the Code.
2. Distributing will recognize no gain or loss on the transfer of the assets to Controlled 1 and Controlled 2. (Section 361(a)).
3. Controlled 1 and Controlled 2 will recognize no gain or loss on their receipt of the transferred assets. (Section 1032).

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4. The basis of the assets received by Controlled 1 and Controlled 2 will be the same as the basis of the assets in the hands of Distributing immediately prior to the transaction. (Section 362 (b)).
5. The holding period of the assets transferred to Controlled 1 and Controlled 2 will include the period during which such assets were held by Distributing. (Section 1223(2)).
6. No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing upon receipt of the stock of Controlled 1 or Controlled 2. (Section 355 (a)).
7. The basis of stock of Controlled 1 in the hands of the Group 1 shareholders and the basis of stock of Controlled 2 in the hands of Group 2 shareholders immediately after the distribution will be the same as the basis of the Distributing stock held by those shareholders immediately before the Distribution. (Section 358 (a)(1) and (b)).
8. The holding period of Controlled 1 stock in the hands of Group 1 shareholders and Controlled 2's stock in the hands of Group 2 shareholders will include the holding period of their distributing stock exchanged, provided that the Distributing stock is held as a capital asset on the date of the Distribution . (Section 1223(1)).
9. Earnings and profits will be allocated between Controlled 1 and Controlled 2 in accordance with sections 312(h) and 1. 312-10(a).

#### Caveats

No opinion is expressed about the tax treatment of the transaction under any other provision of the Code or Regulations, or the tax treatment any condition existing at the time of, or effects resulting from the proposed transaction that are not specifically covered by the above rulings.

#### Procedural Statements

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.

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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.

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

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

Sincerely,

*Reginald Mombrun*

Reginald Mombrun  
Assistant to the Branch Chief(Branch 6)  
Corporate

cc: