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February 22, 2000

Distributing =

A =

B =

State X =

Business 1 =

This letter responds to your request dated October 21, 1999, for rulings on the federal income tax consequences of a proposed transaction. You submitted additional information in a letter dated January 31, 2000. The information submitted for consideration is summarized below.

Distributing, a State X corporation, uses the accrual method of accounting, has a calendar taxable year, and is engaged in Business 1. A and B equally own all the issued and outstanding common stock of Distributing.

We have received financial information indicating that Distributing has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

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Certain disputes have arisen between A and B that are adversely affecting the business of Distributing.

Therefore, the taxpayers have proposed the following transaction:

- (i) Distributing will form Controlled as a wholly owned corporation. Controlled will be a State X corporation, use the accrual method of accounting, and have a calendar taxable year.
- (ii) Distributing will transfer certain assets of Business 1 to Controlled in exchange for all of the stock of Controlled and the assumption of liabilities.
- (iii) Distributing will distribute all of the Controlled stock to B in exchange for all of B's Distributing stock.

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

- (a) The fair market value of the Controlled stock to be received by B will be approximately equal to the fair market value of the Distributing stock surrendered by B 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 Distributing.
- (c) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operations, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) 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 to consummation of the transaction.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purpose: To resolve shareholder disputes. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing or Controlled to make an S corporation

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election pursuant to § 1362(a).

- (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 or Controlled after the transaction.
- (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 transaction, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696.
- (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 transaction, except in the ordinary course of business.
- (j) 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 the liabilities to which the transferred assets are subject; and the liabilities assumed in the transaction and the liabilities to which the assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (k) No investment credit has been or will be claimed with respect to any property being transferred between Distributing and Controlled.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (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) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (o) The distribution is 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% or more of the total combined voting power of all classes of stock of Distributing or Controlled, or stock possessing 50% or more of the total value of all classes of stock of Distributing or Controlled.

Based solely on the information submitted and representations made, we hold as follows:

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- (1) The transfer by Distributing of certain assets of Business 1 to Controlled solely in exchange for all of the stock of Controlled and the assumption of liabilities followed by the distribution of all of the Controlled stock to B in exchange for all of B's Distributing stock, as described above, will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of the Distributing assets, subject to liabilities, to Controlled in exchange for the Controlled stock (§§ 361(a) and § 357(a)).
- (3) Controlled will recognize no gain or loss upon the receipt of the Distributing assets in exchange for the Controlled stock (§ 1032(a)).
- (4) Controlled's basis in each asset to be received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (5) Controlled's holding period for each asset to be received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).
- (6) Distributing will recognize no gain or loss upon the distribution of the Controlled stock to B (§ 361(c)).
- (7) B will recognize no gain or loss (and no amount will be included in B's income) upon the receipt of Controlled stock in exchange for B's Distributing stock (§ 355(a)(1)).
- (8) The basis of the Controlled stock to be received by B in the transaction will equal B's basis in the Distributing stock surrendered in exchange therefor (§ 358(a)).
- (9) The holding period of the Controlled stock to be received by B in the transaction will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset on the date of the distribution (§ 1223(1)).
- (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 proposed transaction under other provisions of the Internal Revenue Code and regulations or about 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.

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

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By *Ken Cohen*

Ken Cohen
Senior Technician Reviewer, Branch 3