

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

February 22, 2001

Re:

Distributing =

Controlled =

Shareholder A =

Shareholder B =

aa =

bb =

business m =

business n =

State Z =

Date a =

Date b =

This is in response to your letter dated October 31, 2000, for rulings concerning the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated January 3, 2001, January 4, 2001 and February 8, 2001. The material information submitted for consideration is summarized below.

Distributing, a State Z corporation, is engaged in business m and business n. Distributing has two shareholders, Shareholder A and Shareholder B, (collectively "the Shareholders") who own aa% and bb% interests, respectively. Controlled will be a separate and independent State Z corporation engaged in business n. Distributing uses the accrual method of accounting for its federal income tax return, and has a taxable year ending on Date a.

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

Significant disagreements between the Shareholders have taken place which have adversely effected the management and operations of Distributing. Accordingly, the directors of Distributing propose the following transaction.

(1) Pursuant to an executed Agreement and Plan of Corporate Separation and Reorganization, signed on Date b, Distributing will form Controlled, a wholly owned subsidiary. Controlled will use the cash method of accounting.

(2) Distributing will transfer business assets and liabilities relating to business n to Controlled, in exchange solely for all of the outstanding voting stock of Controlled. None of the property being transferred in the proposed transaction between Distributing and Controlled is subject to investment credit recapture.

(3) Distributing will distribute all of the Controlled stock to Shareholder A in exchange for all of Shareholder A's Distributing stock.

Following the transaction Controlled will be wholly owned by Shareholder A, and Distributing will be wholly owned by Shareholder B.

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

(a) Any indebtedness owed by Controlled to Distributing after the distribution of Controlled stock will not constitute stock or securities.

(b) The fair market value of the Controlled stock to be received by Shareholder A will be approximately equal to the fair market value of the Distributing stock surrendered by Shareholder A in the exchange.

(c) 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 the corporation.

(d) The 5 years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to such corporation, there has been no substantial operational changes since the date of the last financial statements submitted.

(e) Following the transaction, Distributing and Controlled will each continue the active

conduct of its business, independently and with its separate employees.

(f) The proposed distribution of the stock of Controlled is carried out for the following corporate business purpose: to end shareholder disputes, resolve management deadlock and alleviate associated inefficiencies. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.

(g) There is no plan or intention by any shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either 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.

(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 proposed 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 equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject; and 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) Distributing has neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(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 either Distributing or Controlled, or stock possessing 50% or more of the total value of all classes of stock of either Distributing or Controlled.

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

Based solely on the information submitted and the representations as set forth above it is held as follows:

(1) The transfer by Distributing of certain assets and liabilities to Controlled solely in exchange for all of the stock of Controlled and the assumption by Controlled of certain liabilities of Distributing followed by the distribution of the Controlled stock to Shareholder A in exchange for all Shareholder A'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 its assets and liabilities to Controlled in exchange for Controlled stock and the assumption by Controlled of certain liabilities (§§ 361(a) and 357(a)).

(3) Controlled will recognize no gain or loss on the receipt of the Distributing assets received in exchange for Controlled stock (§ 1032(a)).

(4) Controlled's basis in each asset 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 received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).

(6) Distributing will recognize no gain or loss on the distribution of the Controlled stock to Shareholder A (§ 361(c)(1)).

(7) Shareholder A will recognize no gain or loss (and no amount will be included in Shareholder A's income) upon receipt of Controlled stock in exchange for Shareholder A's Distributing stock (§ 355(a)(1)).

(8) The basis of the Controlled stock received by Shareholder A in the transaction will equal the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

(9) The holding period of the Controlled stock received by Shareholder A in the transaction will include the holding period of the Distributing stock surrendered in

exchange therefor, provided Shareholder A held the Distributing stock 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) of the Income Tax Regulations.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the proposed transaction under any other provision of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from the proposed transaction.

A copy of this letter should 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.

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.

Sincerely yours,
Associate Chief Counsel (Corporate)
By *Ken Cohen*
Senior Technical Reviewer, Branch 3