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Department of the Treasury

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Date:

April 3, 2002

Distributing =

Controlled =

State N =

A =

B =

C =

d =

e =

f =

g =

h =

i =

j =

Business Z =

Year 1 =

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Date 1 =

k =l =

We respond to your letter dated November 30, 2001, requesting rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in and with a letter dated March 13, 2002. The information submitted for consideration is summarized below.

Distributing is a State N corporation that has outstanding d shares of Class A voting stock and e shares of Class B nonvoting common stock, both classes of which are owned by two brothers (A and B) and their lineal decendants and their sister, C, and other minority interests. The A Group of shareholders collectively owns f shares of the Class A stock and g shares of the Class B stock. The B Group of shareholders collectively owns f shares of the Class A stock and h shares of the Class B stock. C and other minority interests collectively own i shares of the Class A stock and j shares of the Class B stock.

Controlled is a State N corporation recently formed to effectuate the proposed transaction.

Distributing has been engaged continuously in Business Z since Year 1. Distributing has provided financial information that indicates that Distributing has had gross receipts and operating expenses representative of the active conduct of Business Z for the past 5 years.

Due to disagreements over the management, operation, and expansion of Business Z and as a result of a mediated settlement reached on Date 1 of a lawsuit between the shareholder groups, the A Group and the B Group, together with C and the minority interests, have decided to divide Distributing's business assets and liabilities and go their separate ways. Accordingly, they propose the following transaction:

(i) Distributing will transfer to Controlled a portion of its assets in exchange for k shares of Controlled Class A voting common stock and l shares of Controlled Class B non voting common stock and Controlled's assumption of liabilities.

(ii) Distributing then will distribute all of these shares of Controlled stock to the A Group shareholders, categorically and proportionately, in exchange for all of their shares of Distributing stock, with the result that no member of the A group will own any stock in Distributing after the exchange.

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

- (a) The fair market value of the stock of Controlled received by each of the A Group shareholders will be approximately equal to the fair market value of the Distributing stock to be surrendered by each of the A Group shareholders 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 the corporation.
- (c) The 5 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 statement submitted.
- (d) Following the transaction, Distributing and Controlled each will continue, independently and with its separate employees, the active conduct of its share of all of the integrated activities of the business conducted by Distributing prior to the consummation of the transaction.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purposes: to resolve shareholder disputes and different management plans; and to comply with a mediated settlement resulting from a lawsuit between the shareholder groups. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) Distributing is an S corporation (within the meaning of §1361(a) of the Internal Revenue Code) and Controlled will elect to be an S corporation pursuant to §1362(a) on the first available date after the proposed transaction. There is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.
- (g) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, have redeemed, 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, 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 either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or

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otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.

- (j) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under §357(d)) by Controlled. The liabilities assumed (as determined under §357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.
- (k) No property is being transferred between Distributing and Controlled upon which any investment credit determined under §46 has been or will be claimed.
- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (n) There are no continuing, planned, or intended transactions between Distributing and Controlled following the distribution, but any payments made in connection with all continuing transactions, if any, will be for fair market value based on the terms and conditions arrived at by the parties bargaining at arm's length.
- (o) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv).
- (p) 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 percent or more of the total combined voting power of all classes of stock entitled to vote or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.

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

- (1) The transfer by Distributing to Controlled of assets in exchange for the stock of Controlled and the assumption of liabilities, followed by the distribution of all of the stock of Controlled to the A Group in exchange for all of the stock of Distributing owned by such shareholder group will qualify as a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled 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 upon the transfer of assets to Controlled solely in exchange for the stock of Controlled and the assumption of liabilities (§§361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled upon the receipt of the assets in exchange for the stock of Controlled (§1032).
- (4) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of Controlled to the A Group shareholders in exchange for all of their stock in Distributing (§361(c)(1)).
- (5) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately before their transfer to Controlled (§362(b)).
- (6) The holding period of the assets transferred to Controlled will include the period during which such assets were held by Distributing (§1223(2)).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the A Group shareholders upon receipt of the Controlled stock in exchange for their Distributing stock (§355(a)(1)).
- (8) The basis of the Controlled stock in the hands of each of the A Group shareholders will be the same as the basis of the Distributing stock surrendered by each of them in exchange therefor (§358(a)(1)).
- (9) The holding period of the Controlled stock received by each of the A Group shareholders will include the holding period of the Distributing stock surrendered by each of them, provided such stock is held as a capital asset on the date of the transaction (§1223(1)).
- (10) As provided in §312(h), following distribution of the stock of Controlled, proper allocation of earnings and profits will be made between Distributing and Controlled in accordance with §1.312-10(a) of the Income Tax Regulations.

We express no opinion about the tax treatment of the proposed 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 proposed transaction that are not specifically covered by the about rulings.

The ruling contained in this letter is predicted upon the facts and representations submitted by the taxpayers and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for a ruling. Verification of the information,

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representations, and other data may be required as part of the audit process.

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) 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 letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to the taxpayer's authorized representative.

Sincerely,

Filiz A. Serbes

Filiz A. Serbes
Chief, Branch 3
Office of the Associate Chief Counsel
(Corporate)

cc: