

Internal Revenue Service

Department of the Treasury

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Distributing =

Controlled =

State X =

Jurisdiction Y =

Z =

A =

B =

C =

D =

E =

business a =

This letter replies to a request for rulings, dated October 25, 1999, on the federal income tax consequences of a proposed transaction concerning § 355 of the Internal Revenue Code. We received additional information in letters dated December 16, 1999, January 5, January 12, and February 7, 2000. The information submitted for consideration is summarized below.

Distributing is a State X company with voting and non-voting stock outstanding. The stock is held by members of a family; A, B, C, D, and E. Distributing conducts business a on the accrual method of accounting and uses a fiscal tax year.

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

The taxpayer wishes to separate its business a activities into two corporations because B disagrees with the other shareholders on how business a should be conducted. B believes that some portion of business a should be conducted in Jurisdiction Y while the other shareholders wish to continue to conduct business a solely in State X. This disagreement is having an adverse effect on the day-to-day operations of Distributing. In order to eliminate the problems generated by this situation, the following transaction has been proposed:

- (i) Distributing will organize Controlled as a State X accrual basis corporation with only voting stock outstanding. Distributing will transfer real property, a loan receivable, and cash (the "Controlled assets") to Controlled in exchange for all of the Controlled stock.
- (ii) Distributing will distribute all of the Controlled stock to B in exchange for all of his Distributing stock.
- (iii) Controlled will exchange State X real property for real property located in Jurisdiction Y.

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) The fair market value of the Controlled stock and other consideration to be received by B approximately equals 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 the corporation.
- (c) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operations, and 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 own separate employees, the active conduct of its share of all of the integrated activities of business a.

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- (e) The distribution of stock of Controlled is being carried out for the following corporate business purpose: avoiding significant existing disagreements and conflicts among the shareholders of Distributing concerning management style and business objectives. The distribution of the stock of Controlled is motivated in whole, or substantial part, by this corporate business purpose.
- (f) 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 either Distributing or Controlled subsequent to the proposed transaction.
- (g) 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.
- (h) There is no plan or intention to liquidate Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation subsequent to the transaction, except in the ordinary course of business or pursuant to the exchange described in paragraph (iii), above.
- (i) There are no liabilities to be assumed in the transaction and there are no liabilities to which the transferred assets are subject.
- (j) No Investment tax credit has been claimed (or will be claimed) on the property to be transferred to Controlled.
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (l) 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.
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) 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 election pursuant to §1362(a).
- (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 percent or more of the combined voting power

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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.

- (p) The State X real property to be exchanged (see paragraph (iii), above) will be disposed of within z days of the distribution. Controlled will continue to conduct business a until it disposes of the real property. Business a will be fully operational in Jurisdiction Y within z days of the date Controlled disposes of the State X real property.

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

- (1) The transfer by Distributing to Controlled of the Controlled assets solely in exchange for all of the stock of Controlled, as described above, followed by the distribution of all of the Controlled stock to B in exchange for all of his Distributing stock 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 assets to Controlled in exchange for Controlled stock, as described above (§ 361(a)).
- (3) Controlled will recognize no gain or loss on the receipt of Controlled assets in exchange for Controlled stock (§ 1032(a)).
- (4) The basis of each asset received by Controlled will be the same as the basis of that asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (5) The holding period of the Controlled assets will include the period during which these assets were held by Distributing (§ 1223(2)).
- (6) B will not recognize gain or loss (and no amount will be included in the income of B) upon the receipt of the Controlled stock in exchange for all of his Distributing stock, as described above (§ 355(a)(1)).
- (7) Distributing will recognize no gain or loss upon the distribution of all of its Controlled stock (§ 361(c)).
- (8) B 's basis in his Controlled stock will equal the aggregate basis of his Distributing stock surrendered in the exchange (§ 358(a)(1)).

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- (9) The holding period of the Controlled stock received by B will include the holding period of the Distributing stock surrendered in the exchange, provided that the Distributing stock is held as a capital asset on the date of the exchange (§ 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.

No opinion was requested and no opinion is expressed about the exchange of real property described in paragraph (iii), above. Specifically, we express no opinion whether the non-recognition provisions of § 1031 apply to paragraph (iii). Additionally, 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 above rulings.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each affected taxpayer must attach a copy of this letter to the taxpayer's federal income tax return for the tax year in which the transaction covered by this ruling letter is consummated.

We have sent a copy of this letter to the taxpayer pursuant to the power of attorney on file in this office.

Sincerely yours,
Assistant Chief Counsel (Corporate)
By Ken Cohen
Senior Technician Reviewer, Branch 3