

INTERNAL REVENUE SERVICE

Index Number: 355.01-02

368.04-00

Number: **199921025**

Release Date: 5/28/1999

CC:DOM:CORP:3 PLR-120458-98

February 24, 1999

Distributing =

Controlled 1 =

Controlled 2 =

Controlled 3 =

a =

b =

A =

B =

business c =

state X =

PLR-120458-98

date Y =

d =

This letter responds to your request dated October 22, 1998, submitted on behalf of Distributing, for rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated January 26, February 8 and February 19, 1999. The information submitted for consideration is summarized below.

Distributing, a state X corporation, is a closely held corporation that files its federal income tax return utilizing an accrual method of accounting on a calendar year end basis. Distributing has issued and outstanding approximately a shares of common stock, which are held by approximately b shareholders. Distributing has two greater-than-five-percent shareholders, A and B. The sole assets of Distributing, other than a small amount of cash, consist of 100 percent of the outstanding voting common stock (the only class of stock outstanding) of Controlled 1, Controlled 2 and Controlled 3, each of which are state X corporations. Controlled 1, Controlled 2 and Controlled 3 are each engaged in business c. Distributing, Controlled 1, Controlled 2 and Controlled 3 join in the filing of a consolidated federal income tax return.

We have received financial information indicating that each of Controlled 1's, Controlled 2's and Controlled 3's business c have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

It has been determined that the elimination of Distributing as a holding company will provide substantial cost savings. Financial information, documentation and analysis have been provided that demonstrates that cost savings resulting from the elimination of Distributing on an after tax basis, after taking into account the costs of the transaction, will be in excess of one percent of the consolidated net income for the five year measurement period.

In order to accomplish this cost savings, Distributing and Controlled 1, Controlled 2 and Controlled 3 propose the following series of steps for the proposed transaction:

- (i) The common stock of each of Controlled 1, Controlled 2 and Controlled 3 will be converted to the number of shares needed for a share-for-share exchange with the current Distributing shareholders.
- (ii) Cash in the amount of \$ d (a *de minimis* amount of cash) held by Distributing will be contributed to the capital of Controlled 3.

PLR-120458-98

- (iii) Distributing will distribute to its shareholders, *pro rata*, all the stock of each of Controlled 1, Controlled 2 and Controlled 3 so that each holder of Distributing shall receive one share of each of Controlled 1, Controlled 2 and Controlled 3 for each share of Distributing, which will be exchanged therefor (the "Distribution"). The Distribution will occur no earlier than date Y.
- (iv) Following the Distribution, Distributing will dissolve.
- (v) A will transfer the Controlled 3 stock received in the transaction to his spouse, and A will transfer minority interests in Controlled 1 and Controlled 2 to their two daughters.

The following representations have been made concerning the proposed transaction:

- (a) The fair market value of the Controlled 1, Controlled 2 and Controlled 3 stock received by each shareholder of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by such shareholder in the exchange.
- (b) No part of the consideration distributed by Distributing is being received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The 5 years of financial information submitted on behalf of Distributing (including Controlled 1, Controlled 2 and Controlled 3) is representative of their present operation, and with regard to such corporations, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the proposed transaction, Controlled 1, Controlled 2 and Controlled 3 will each continue, independently and with its separate employees, the active conduct of its business.
- (e) The distribution of the stock of Controlled 1, Controlled 2 and Controlled 3 is carried out for the following corporate business purpose: cost savings. The distribution of the stock of Controlled 1, Controlled 2 and Controlled 3 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 any of Controlled 1, Controlled 2 or Controlled 3 after the transaction, except for the proposed intra-family (within the meaning of § 267(c)(4)) transfer of stock of Controlled 3 from A to his spouse and the proposed transfer of minority interests in Controlled 1 and Controlled 2 to their two daughters.

PLR-120458-98

- (g) There is no plan or intention by Controlled 1, Controlled 2 or Controlled 3, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the proposed distribution, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (h) Distributing will liquidate as a result of the transaction. There is no plan or intention to liquidate Controlled 1, Controlled 2 or Controlled 3, to merge any of Controlled 1, Controlled 2 or Controlled 3 with any other corporation, or to sell or otherwise dispose of the assets of any of Controlled 1, Controlled 2 or Controlled 3 subsequent to the proposed transaction, except in the ordinary course of business.
- (i) None of Controlled 1, Controlled 2 or Controlled 3 are assuming any liabilities or receiving assets subject to liabilities from Distributing.
- (j) No intercorporate debt will exist between Distributing and Controlled 1, Controlled 2 or Controlled 3 at the time of, or subsequent to, the distribution of the Controlled 1, Controlled 2 and Controlled 3 stock.
- (k) Immediately before the distribution, items of income, gain, loss, deduction, and credit, if any, will be taken into account as required by the applicable intercompany transaction regulations. Further, Distributing's excess loss account with respect to the Controlled 1, Controlled 2 or Controlled 3 stock, if any, will be included in income immediately before the distribution.
- (l) Payments made in connection with all continuing transactions, if any, between Controlled 1, Controlled 2 and Controlled 3, 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) 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 of Controlled 1, Controlled 2 or Controlled 3, or stock possessing 50 percent or more of the total value of all classes of stock of Controlled 1, Controlled 2 or Controlled 3.
- (o) Distributing is not an S corporation (within the meaning of § 1361(a)). Distributing will not exist after the proposed transaction, and there is no plan or intention by any of Controlled 1, Controlled 2 or Controlled 3 to make an S corporation election pursuant to § 1362(a).

PLR-120458-98

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

- (1) The transfer by Distributing to Controlled 3 of the cash described in step (ii), above, solely in constructive exchange for additional shares of Controlled 3 stock, followed by the pro rata distribution of the Controlled 3 stock in exchange for Distributing stock, as described above, will be a reorganization within the meaning of § 368(a)(1)(D) of the Code. Distributing and Controlled 3 will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) Controlled 3 will recognize no gain or loss on its receipt of cash in constructive exchange for additional shares of Controlled 3 stock, as described above (§ 1032(a)).
- (3) Distributing will recognize no gain or loss upon its distribution of its Controlled 3 stock in exchange for Distributing stock, as described above (§ 361(c)(1)).
- (4) Distributing will recognize no gain or loss upon its distribution of its Controlled 1 and Controlled 2 stock in exchange for Distributing stock, as described above (§ 355(c)(1)).
- (5) No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing on their receipt of each of the Controlled 1, Controlled 2 and Controlled 3 stock in exchange for all of their Distributing stock, as described above (§ 355(a)(1)).
- (6) A Distributing shareholder's basis in the stock of Controlled 1, Controlled 2 and Controlled 3 received in the transaction will, in each instance, equal the aggregate basis of the Distributing stock held immediately before the transaction and surrendered in exchange therefor, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(a) and (b)).
- (7) A Distributing shareholder's holding period of the Controlled 1, Controlled 2 and Controlled 3 stock received in the proposed transaction will include the holding period of the Distributing stock surrendered in exchange therefor, provided that

PLR-120458-98

the Distributing shareholder held such stock as a capital asset on the date of the exchange (§ 1223(1)).

- (8) Proper allocation of earnings and profits between Controlled 1, Controlled 2 and Controlled 3 will be made pursuant to § 312(h) and § 1.1502-33.

No opinion is expressed about the tax treatment of the 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 transaction that are not specifically covered by the above rulings.

The above rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) of the Code provides that these rulings may not be used or cited as precedent.

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.

Pursuant to a power of attorney on file in this office, we have sent a copy of this letter to the taxpayer.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Ken Cohen

Ken Cohen
Senior Technician Reviewer, Branch 3