

## Internal Revenue Service

## Department of the Treasury

Number: **200138025**

Washington, DC 20224

Release Date: 9/21/2001

Index Number: 0368.04-00, 0355.01-00

Person to Contact:

Telephone Number:

Refer Reply To:

**CC:CORP:B03-PLR-114993-01**

Date:

**June 26, 2001**

Re:

Distributing =

Controlled =

State N =

A =

B =

C =

D =

e =

f =

g =

h =

X =

Y =

Business =

Year =

Year =

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Date =

We respond to your letter dated February 26, 2001, requesting rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated June 22 and June 25, 2001. The information submitted for consideration is summarized below.

Distributing is a State N corporation that has outstanding e shares of Class A voting common stock, which are owned by A (f shares) and B (f shares), and g shares of Class B voting common stock, which are owned by C (h shares) and D (h shares). Controlled will be a State N corporation formed to effectuate the proposed transaction. Controlled will have authorized i shares of \$1.00 par value voting common stock.

Distributing has been engaged in Business Z since Year 1 and presently is engaged in that business through the ownership and operation of X and Y. Distributing has owned and operated X since Year 2. Distributing also has owned Y since Year 2, but had leased Y to an unrelated third party pursuant to a 10-year lease, which ended Date 3. Distributing has been operating Y since that date.

Financial information has been received which indicates that Distributing has had gross receipts and operating expenses representative of the active conduct of X for the past 5 years and for Y as an expansion of Distributing's business since Date 3.

Due to disagreements over the management, operation and expansion of X, A and B together with C and D 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 the newly-formed Controlled all of the assets and liabilities related to Y (the Y Assets). In exchange, Distributing will receive all of the issued and outstanding shares of Controlled voting stock and the assumption by Controlled of the liabilities associated with Y (the Y Liabilities); and
- (ii) Distributing then will distribute all of the shares of Controlled stock to C and D, in equal parts, in exchange for all of their shares of Distributing stock.

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 C and D will be approximately equal to the fair market value of the Distributing stock surrendered by C and D in the exchange.

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- (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 by enabling the expansion of X without subjecting Y to that liability; and to eliminate any cross collateralization and additional business risks and contingent liability of Y for X debt. The distribution of the stock of the Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) Distributing is not an S corporation (within the meaning of § 1361(a) of the Internal Revenue Code), and immediately before the distribution, Distributing will be eligible to make an S corporation election pursuant to § 1362(a). Distributing and Controlled may elect to be an S corporation pursuant to § 1362(a) after the distribution, and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled if such election is made.
- (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.
- (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 basis and the fair market value of the assets

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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) The investment tax credit previously computed with respect to any investment credit property (including any building to which § 47(d) applies) that is transferred from Distributing to Controlled will be adjusted in the year of the transfer to reflect an early disposition of the property pursuant to § 50(a)(1) or (2) (or pursuant to § 47(a)(1) and (5) as previously in effect, if applicable) or pursuant to any applicable successor statutes.
- (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 transaction 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 the Y Assets, in exchange for the stock of Controlled and the assumption of the Y Liabilities, followed by the distribution of all of the stock of Controlled to C and D in exchange for all of the stock of Distributing owned by such shareholders 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 the Y Assets to Controlled solely in exchange for stock of Controlled and the assumption of the Y 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 C and D (§ 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) C and D 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 C and D 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 C and D 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 among 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 above rulings.

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

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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 yours,  
Associate Chief Counsel (Corporate)  
By: Filiz A. Serbes  
Chief, Branch 3