

Internal Revenue Service

Department of the Treasury

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Distributing =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Shareholder F =

Shareholder G =

a =

b =

c =

Business 1 =

Asset 1 =

Activity 1 =

Activity 2 =

State X =

Year Y =

PLR-114397-99

This letter responds to a request dated August 6, 1999, for rulings on the federal income tax consequences of a proposed transaction. You submitted additional information in letters dated September 20, 1999, October 18, 1999, and November 30, 1999. The information submitted for consideration is summarized below.

Distributing, a State X corporation, uses the cash method of accounting, has a calendar tax year and is engaged in Business 1. Distributing's only class of outstanding stock consists of shares of common stock and is owned in the following percentages: Shareholder A, Shareholder B, Shareholder C, and Shareholder D each own a%, Shareholder E owns b%, and Shareholder F and Shareholder G each own c%.

We have received financial information which indicates that Business 1 has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Certain disputes have arisen between all the shareholders that are adversely affecting the business of Distributing. The taxpayers have demonstrated that there are valid business reasons why any one shareholder cannot continue to own a corporation with any other shareholder. Accordingly, the taxpayers have proposed the following transaction.

- (i) Distributing will form Controlled A, Controlled B, Controlled C, Controlled D, Controlled E, Controlled F, and Controlled G (each a "Controlled Corporation" and together the "Controlled Corporations") as wholly owned subsidiaries. The Controlled Corporations will be State X corporations, use the cash method of accounting, and have a calendar taxable year.
- (ii) Distributing will transfer a% of its Asset 1 assets and other assets to each of Corporation A, Corporation B, Corporation C, and Corporation D, in exchange for the stock of each such Controlled Corporation and the assumption of liabilities by each such Controlled Corporation. Distributing will transfer b% of its Asset 1 assets and other assets to Corporation E in exchange for the stock of such Controlled Corporation and the assumption of liabilities by such Controlled Corporation. Distributing will transfer c% of its Asset 1 assets and other assets to each of Corporation F and Corporation G, in exchange for the stock of each such Controlled Corporation and the assumption of liabilities by each such Controlled Corporation.
- (iii) Distributing will distribute the stock of all the Controlled Corporations to its shareholders in exchange for all of their stock in Distributing as follows: Corporation A to Shareholder A; Corporation B to Shareholder B; Corporation C to Shareholder C; Corporation D to Shareholder D;

PLR-114397-99

Corporation E to Shareholder E; Corporation F to Shareholder F; and Corporation G to Shareholder G.

- (iv) Distributing will be dissolved.

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

- (a) The fair market value of the Controlled Corporation stock and other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder 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) Except for the sale of Activity 1 in an unrelated transaction in Year Y, the five years of financial information submitted on behalf of Distributing is representative of its present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, each Controlled Corporation will continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of Business 1 conducted by Distributing prior to the consummation of the transaction.
- (e) The distribution of the stock of each Controlled Corporation is carried out for the following corporate business purposes: To resolve shareholder disputes. The distribution of the stock of each Controlled Corporation is motivated, in whole or in 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 Controlled Corporation after the transaction.
- (g) There is no plan or intention by any Controlled Corporation, directly or through any subsidiary, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696.
- (h) There is no plan or intention to liquidate any Controlled Corporation, to merge any corporation with any other corporation, or to sell or otherwise dispose of the

PLR-114397-99

assets of any Controlled Corporation after the transaction, except in the ordinary course of business.

- (i) The total adjusted bases and the fair market value of the assets transferred to each Controlled Corporation by Distributing each equals or exceeds the sum of the liabilities assumed by each Controlled Corporation plus any liabilities to which the transferred assets are subject. 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.
- (j) No investment credit determined under § 46 has been (or will be) claimed with respect to any of the property transferred between Distributing and the Controlled Corporations.
- (k) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (l) No intercorporate debt will exist between Distributing or any Controlled Corporation at the time of, or subsequent to, the distribution of each Controlled Corporation.
- (m) There will be no continuing transactions between any of the Controlled Corporations except for Activity 2. Payments made in connection with all such continuing transactions between any of the Controlled Corporations 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) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by any of the Controlled Corporations to make an S corporation election pursuant to § 1362(a).
- (p) The distributions are 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 Distributing or any Controlled Corporation, or stock possessing 50% or more of the total value of all classes of stock of Distributing or any Controlled Corporation.

Based solely on the information submitted and representations made, we hold as follows:

PLR-114397-99

- (1) The transfer by Distributing of its assets to each Controlled Corporation, in exchange for all the stock of each Controlled Corporation, and the assumption of certain liabilities, as described above, followed by the distribution of Corporation A to Shareholder A; Corporation B to Shareholder B; Corporation C to Shareholder C; Corporation D to Shareholder D; Corporation E to Shareholder E; Corporation F to Shareholder F; and Corporation G to Shareholder G, will each be a reorganization within the meaning of § 368(a)(1)(D), respectively. Distributing and each Controlled Corporation will 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, subject to liabilities, to each Controlled Corporation in exchange for all the stock of each Controlled Corporation, as described above (§ 361(a) and § 357(a)).
- (3) Each Controlled Corporation will recognize no gain or loss on the receipt of the respective assets in exchange for its stock, as described above (§ 1032(a)).
- (4) Each Controlled Corporation's basis in the assets received from Distributing will equal the basis of such assets in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (5) Each Controlled Corporation's holding period in the assets received in the transaction will include the period during which Distributing held such asset (§ 1223(2)).
- (6) Distributing will recognize no gain or loss on the distribution of each Controlled Corporation to the Distributing shareholders, as described above (§ 361(c)).
- (7) The Distributing shareholders will recognize no gain or loss (and no amount will be included in their income) upon the receipt of their respective Controlled Corporation's stock in exchange for their Distributing stock, as described above (§ 355(a)(1)).
- (8) The basis of the stock of the Controlled Corporation stock to be received by each shareholder in the transaction will equal their respective basis in the Distributing stock surrendered in exchange therefor (§ 358(a)).
- (9) A Distributing shareholder's holding period of the Controlled Corporation's stock received in the transaction will, in each instance, include the holding period of the Distributing stock with respect to which the distribution is made, provided that the shareholder 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 each

PLR-114397-99

Controlled Corporation will be made under § 1.312-10(a).

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 taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By *Ken Cohen*

Senior Technician Reviewer, Branch 3