

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

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Refer Reply To:

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Date:

**June 24, 1999**

Re:

Distributing =

Controlled 1 =

Controlled 2 =

Shareholder 1 =

Shareholder 2 =

State N =

Business A =

Year 1 =

a =

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b =

Type C =

Insurance Company =

Dear :

This is in reply to your letter dated March 5, 1999, requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was provided by a letter dated June 10, 1999. The information submitted is summarized below.

Distributing is a State N corporation that is an accrual basis taxpayer and a Subchapter C corporation. Distributing is a holding company with no business operations of its own that has continuously engaged in Business A since its incorporation in Year 1 through its two wholly-owned subsidiaries, Controlled 1 and Controlled 2. Distributing has outstanding a shares of Class A voting common stock (the Class A stock) that are entirely owned by Shareholder 1 and b shares of Class B voting common stock (the Class B stock) that are entirely owned by Shareholder 2.

Financial information has been received which indicates that each business of Controlled 1 and Controlled 2 has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the last five years.

To allow each of the shareholders to go their separate ways and enhance the efficiency and profitability of each of the two businesses, the taxpayer proposes that:

- (i) Distributing will distribute all of the stock of Controlled 2 to Shareholder 2 in exchange for all of its stock (the Class B stock) in Distributing; and
- (ii) Distributing, with Shareholder 1 as its sole continuing shareholder of Class A stock, will continue to operate as a holding company for all of the stock of Controlled 1. The Class A stock will constitute 100 percent of the issued and outstanding stock of Distributing.

Distributing, Controlled 1, and Controlled 2 and their shareholders have entered into a Separation Agreement to govern this proposed transaction. Under this agreement, in relevant part, a final settlement of the value of Distributing's equity account in its Type C insurance policy issued by Insurance Company owed by Distributing to Controlled 2 shall be reflected in a promissory note to be made by Distributing in favor of Controlled 2. Such promissory note shall provide for payments

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by Distributing to Controlled 2 as Distributing receives payments (i.e., return of the equity account), if any, from Insurance Company. Any amount owed by Controlled 2 to Distributing with respect to this account is payable by Controlled 2 to Distributing within 10 days of the determination of such amount.

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

- (a) The fair market value of the Controlled 2 stock to be received by Shareholder 2 of Distributing will be approximately equal to the fair market value of Distributing's stock surrendered by Shareholder 2 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 and the controlled corporations is representative of each corporation's present operations, and with regard to such corporations, there have been no substantial operational changes since the date of the last financial statement submitted.
- (d) Immediately after the distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (e) Following the transaction, Distributing (through Controlled 1) and Controlled 2 will continue the active conduct of its business, independently and with its separate employees.
- (f) The distribution of the stock of Controlled 2 is carried out for the following corporate business purposes: the desire of the shareholders of Distributing to go their separate ways in order to enhance the efficiency and profitability of the controlled corporations. The distribution of the stock of Controlled 2 is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (g) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing or controlled corporations to make an S corporation election pursuant to § 1362(a).
- (h) There is no plan or intention by the shareholders of Distributing to sell,

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exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing, Controlled 1, or Controlled 2 after the transaction.

- (i) There is no plan or intention by the shareholders of Distributing, Controlled 1, or Controlled 2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through a stock purchase meeting the requirements of § 4.05(1)(b) of Revenue Procedure 96-30.
- (j) There is no plan or intention to liquidate either Distributing or the controlled corporations, to merge the corporation(s) with any other corporation, or to sell or otherwise dispose of the assets of any corporation after the transaction, except in the ordinary course of business.
- (k) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (l) Immediately before the distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (See § 1.1502-13 and § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-21 I.R.B. 6, and as currently in effect, § 1.1502-13 as published by T.D. 8597). Further, any excess loss account with respect to the Controlled 2 stock will be included in income immediately before the distribution (See § 1.1502-19).
- (m) No intercorporate debt will exist between Distributing and the controlled corporations at the time of, or subsequent to, the distribution of the Controlled 2 stock, except as provided in the Separation Agreement, as described above.
- (n) There will not be any continuing, planned or intended, transactions between Distributing and Controlled 2 following the distribution. In the event there should be any such transactions, payments made in connection with all continuing transactions between Distributing and the controlled corporations will be for fair market value based on terms and conditions arrived at by the parties bargaining at arms length.
- (o) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (p) There is no plan or intention pursuant to which one or more persons shall acquire directly or indirectly stock representing a 50 percent or greater interest in Distributing or Controlled 2 following the proposed transaction

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(§ 355(e)).

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

- (1) No gain or loss will be recognized to (and no amount will be included in the income of) Shareholder 2 on the receipt of the stock of Controlled 2 in exchange for all of its shares of Distributing Class B stock (§ 355(a)).
- (2) Shareholder 2's basis in the Controlled 2 stock received in the transaction will be the same as its basis in the Distributing stock exchanged therefor immediately before the transaction (§ 358(a)(1)).
- (3) The holding period of the Controlled 2 stock received in the transaction will be the same as Shareholder 2's holding period in the Distributing stock exchanged therefor, provided that such Distributing stock is held as a capital asset on the date of the transaction (§ 1223(1)).
- (4) No gain or loss will be recognized by Distributing upon the distribution of all of its stock in Controlled 2 to Shareholder 2 in exchange for all of Shareholder 2's Distributing stock (§ 355(c)(1)).
- (5) Proper allocation of earnings and profits between Distributing and Controlled 2 will be made in accordance with section 1.312-10(b) of the Income Tax Regulations (§ 312(h)).
- (6) Payments made by Distributing to Controlled 2 or by Controlled 2 to Distributing pursuant to the Separation Agreement, including payments relating to the equity account in Insurance Company, as described above, that (i) have arisen or will arise for a taxable period ending before the proposed distribution or for a taxable period beginning on or before and ending after the proposed distribution and (ii) will not become fixed and ascertainable until after the proposed distribution, will be treated as occurring immediately before the proposed distribution.

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

This ruling is directed only to the taxpayer requesting 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 federal income tax

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return for the taxable year in which the transaction covered by this letter is consummated.

In accordance with the power of attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

Assistant Chief Counsel (Corporate)

By:

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Filiz A. Serbes

Assistant to the Chief, Branch 5