

Internal Revenue Service

Department of the Treasury

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Date:

June 1, 2000

Distributing =

Controlled =

Subsidiary 1 =

Subsidiary 1-A =

Subsidiary 2 =

Subsidiary 3 =

A =

B =

C =

D =

E =

Business F =

Business G =

Business H =

a =

b =

c =

d =

e =

f =

State I =

State J =

This letter responds to your January 19, 2000 request for rulings regarding certain federal income tax consequences of a proposed transaction.

Summary of Facts

Distributing is a holding company that owns all of the stock of Controlled, over 90 percent of the stock of Subsidiary 1, and all the stock of Subsidiaries 2 and 3. Subsidiary 1 owns all the stock of Subsidiary 1-A. Distributing files a consolidated return with its subsidiaries. Controlled and Subsidiary 2 conduct Business F, Subsidiaries 1 and 1-A conduct Business G, and Subsidiary 3 conducts Business H. The Distributing common stock is owned a percent by A, b percent by B, c percent by C, d percent by D, and e percent by E. A, B, and D are immediate family members. C is a relative of such family. E is a step-parent of C.

We have received financial information indicating that each of Businesses F, G, and H has had gross income and operating expenses representing the active conduct of a trade or business for each of the past five years.

C, who primarily manages Controlled, has had disagreements on business policy with other Distributing shareholders. In addition, Controlled's headquarters are located in State J, a great distance from Distributing's headquarters in State I. In order to resolve the shareholder disputes and to save the significant cost of travel between the two headquarters as well as travel to neutral meeting sites, it is proposed that Distributing be separated from Controlled as follows:

- (i) In anticipation of the Distribution (as defined below), Distributing transferred cash to Controlled (the "Contribution"). The purpose of the Contribution was to equalize the value of the Controlled stock to be distributed in the Distribution (as defined below) and the Distributing stock to be exchanged therefor. Part of the cash transferred in the Contribution was used immediately by Controlled to repay an intercompany debt from Controlled to Distributing.
- (ii) Distributing will distribute all of the stock of Controlled to C in exchange for all of C's stock in Distributing (the "Distribution").

Representations

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

- (a) No indebtedness of Controlled to Distributing after the Distribution of Controlled stock will constitute stock or securities.

- (b) The fair market value of the Controlled stock received by C will be equal to the fair market value of the Distributing stock surrendered by C in the exchange.
- (c) 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 a corporation.
- (d) The 5 years of financial information submitted on behalf of Distributing is representative of the corporation's present operations. There has been no substantial operating changes since the date of the last financial statement submitted.
- (e) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 335(b)(2).
- (f) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with separate employees.
- (g) The Distribution is being carried out to resolve management disagreements between the shareholders who manage Distributing and Controlled and to achieve significant cost savings by eliminating the need for managers and supervisors to travel between Distributing's and Controlled's geographically distant headquarters or to attend a meeting at a neutral site.
- (h) 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 within the meaning of § 1362(a).
- (i) 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 Distributing or Controlled, except that the remaining shareholders of Distributing after the Distribution will annually offer to sell to other Distributing shareholders stock representing less than 1 percent of the total Distributing stock outstanding.
- (j) 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 Distribution other than stock purchases meeting the requirements of § 4.05(b)(1) of Rev. Proc. 96-30.

- (k) 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 Distribution, except in the ordinary course of business.
- (l) No intercompany debt will exist between Distributing and Controlled at the time of, or subsequent to the Distribution of Controlled stock, except for intercompany accounts that will result from administrative charges from Distributing for the month immediately preceding the Distribution.
- (m) 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 in effect. Distributing has no excess loss account as described in § 1.1502-19 of the Income Tax Regulations with respect to Controlled stock immediately before the Distribution.
- (n) Payments made in connection with all continuing transactions between Distributing and Controlled will be for fair market value based on the terms and conditions arrived at by the parties bargaining at arms length.
- (o) Neither Distributing nor Controlled is an investment company as defined in § 368(a)(2)(F) (iii) and (iv).
- (p) The Distribution is not part of a plan (or series of related transactions) 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 the stock of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of Distributing or Controlled stock, within the meaning of § 355(e).

Rulings

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

- (1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be a “party to a reorganization” under § 368(b).
- (2) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).
- (3) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) C on C’s receipt of Controlled stock in the

Distribution (§ 355(a)(1)).

- (4) The basis of the Controlled stock in the hands of C will equal the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).
- (5) The holding period of the Controlled stock received by C will include the holding period of the Distributing stock exchanged therefor, provided the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (6) 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.

Caveats

We express no opinion on the federal income tax treatment of the proposed transaction under other provisions of the Code or regulations or 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.

Procedural Statements

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

Each taxpayer involved in the transaction must attach a copy of this letter to the taxpayer's federal income tax return for the taxable year in which the transaction is completed.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer.

Sincerely,
Assistant Chief Counsel (Corporate)
By Stephen P. Fattman
Assistant to the Chief, Branch 4