

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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Refer Reply To:

CC:Corp:6-PLR-140854-01

Date:

November 27, 2001

LEGEND:

Distributing =

Controlled =

Business A =

Business B =

Shareholder 1 =

Shareholder 2 =

Location 1 =

Location 2 =

State 1 =

State 2 =

Date 1 =

Date 1 =

\$a =

AA =

This letter responds to your July 12, 2001 request for rulings on certain federal income

tax consequences of a proposed transaction. The information provided in that request is summarized below.

Distributing conducts Business A and is owned 50% by Shareholder 1 and 50% by Shareholder 2. Shareholder 1 is the President of Distributing and Shareholder 2 is the Vice-President of Distributing. Shareholder 1 and Shareholder 2 are brothers.

Financial information has been submitted indicating that Distributing had gross income and operating expenses representing the conduct of an active business during each of the past five years.

Distributing has two manufacturing facilities: one located at Location 1 and the other located at Location 2. The two facilities service two different marketing areas. A major part of the Location 1 marketing area is in State 1, while a majority of the Location 2 marketing area is in State 2. The design, manufacture and installation of AA products in those states are controlled by various governmental agencies. Their requirements often vary from state to state and sometimes from county to county within the states.

A dispute has arisen regarding the best way to operate Business A. Shareholder 1 wants to add a Business B to Distributing. Business B would manufacture components for the Business A operation. Distributing currently has an agreement with an independent company to provide the products Business B would produce. Distributing and Shareholder 2 do not desire to participate in Business B because of the technical skills required in the production process and because of the additional liability associated with it. In addition, Distributing does not choose to participate in the capital investment required for Business B's plant and equipment. Distributing and Shareholder 2 desire to remain fully focused on Business A. Shareholder 1 desires to remain active in Business A while adding Business B to its operations.

To allow Shareholder 1 and Shareholder 2 to go their own ways and cause their corporations to conduct Business A in the way each shareholder thinks best, the following transaction occurred:

(i) On Date 1, Distributing formed Controlled as a wholly owned subsidiary. Distributing contributed \$a to Controlled in exchange for 100% of Controlled stock.

The following transactions are proposed:

(i) On Date 2, Distributing will transfer certain Business A assets to Controlled and retain the rest of the Business A assets. Controlled will operate the plant at Location 2 while the Distributing Corporation will operate at the plant Location 1.

(ii) Distributing will distribute all of the Controlled stock to Shareholder 1 in exchange for 100% of his Distributing stock (the "Distribution").

The taxpayer has made the following representations concerning the proposed

transaction:

(a) The fair market value of the Controlled Corporation stock and other consideration to be received by each shareholder of the Distributing Corporation will be approximately equal to the fair market value of the Distributing Corporation stock surrendered by the shareholder in the exchange.

(b) No part of the consideration to be distributed by the Distributing Corporation 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 (5) years of financial information submitted on behalf of the Distributing Corporation is representative of the Corporation's 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, the Distributing and Controlled Corporations will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by the Distributing Corporation prior to consummation of the transaction.

(e) The distribution of the stock, or stock and securities, of the Controlled Corporation is carried out for the following business purposes: 1) to allow the Controlled Corporation to engage in a new line of business, in addition to the active business being transferred, which requires technical skills and capital investment that the Distributing Corporation does not want to make; 2) to facilitate compliance with regulatory agencies of two states in which the Distributing Corporation and Controlled Corporation market their products; and 3) to allow one owner to concentrate on one facility and its marketing area and the other to concentrate on the other facility and its marketing area. The distribution of the stock, or stock and securities, of Controlled Corporation is motivated, in whole or substantial part, by one or more of these corporate business purposes.

(f) There is no plan or intention by the shareholders or security holders of the Distributing Corporation to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either the Distributing or Controlled Corporation after the transaction.

(g) There is no plan or intention by either the Distributing Corporation or the Controlled Corporation, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

(h) There is no plan or intention to liquidate either the Distributing or Controlled Corporation, to merge either corporation with any other corporation, or to sell or to otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.

(i) The total adjusted basis and the fair market value of the assets transferred to the Controlled Corporation by the Distributing Corporation each equals or exceeds the sum of the liabilities assumed by the Controlled Corporation plus any liabilities to which the transferred assets are subject.

(j) 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.

(k) The Distributing Corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(l) No intercorporate debt will exist between the Distributing Corporation and the Controlled Corporation at the time of, or subsequent to, the distribution of the Controlled Corporation stock.

(m) Payments made in connection with all continuing transactions, if any, between the Distributing and Controlled Corporation, 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) The distribution is not part of a plan or a 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 either Distributing Corporation or Controlled Corporation, or stock possessing 50% or more of the total value of all classes of stock of either Distributing Corporation or Controlled Corporation.

(p) The Distributing Corporation is not an S corporation (within the meaning of §1361(a)), and there is no plan or intention by the Distributing or Controlled Corporation to make an S corporation election pursuant to §1362(a).

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

(1) The transfer by Distributing Corporation to Controlled Corporation of the assets, as described above, in exchange for Controlled Corporation stock, and the assumption of liabilities, followed by the distribution of Controlled Corporation stock by Distributing Corporation to Shareholder 1, in exchange for all of his stock in Distributing Corporation, will constitute a reorganization within the meaning of § 368(a)(1)(D). Distributing Corporation and Controlled Corporation are each a "party to a reorganization" within the meaning of § 368(b).

(2) No gain or loss will be recognized by Distributing Corporation upon the transfer of

assets, subject to liabilities, to Controlled Corporation in exchange for Controlled Corporation stock. (Sections 357(a) and 361(a)).

(3) No gain or loss will be recognized by Controlled Corporation on the receipt of the assets from Distributing Corporation in constructive exchange for shares of Controlled Corporation stock. (Section 1032(a)).

(4) The basis of the assets received by Controlled Corporation will be the same as the basis of such assets in the hands of Distributing Corporation immediately prior to the transaction. (Section 362(b)).

(5) The holding period of each Distributing Corporation asset received by Controlled Corporation will include the period during which that asset was held by Distributing Corporation. (Section 1223(2)).

(6) No gain or loss will be recognized by Distributing Corporation upon the distribution of all of the Controlled Corporation stock to Shareholder 1, in exchange for all of his stock in Distributing Corporation, as described above. (Section 361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder 1 upon receipt of the Controlled Corporation stock. (Section 355(a)(1)).

(8) The basis of the Controlled Corporation stock in the hands of Shareholder 1 immediately after the exchange will be the same as the basis of the Distributing Corporation stock exchanged therefor. (Section 358(a)(1)).

(9) The holding period of the Controlled Corporation stock received by Shareholder 1 will include the holding period of the Distributing Corporation stock exchanged therefor provided that the Distributing Corporation stock is held as a capital asset on the date of the Distribution. (Section 1223(1)).

(10) As provided in § 312(h), proper allocation of earnings and profits between Distributing Corporation and Controlled Corporation will be made under § 1.312-10(a) of the Income Tax Regulations.

We express no opinion about the tax treatment of the transaction under any other section of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered in the above rulings.

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

The rulings contained in this letter are based upon information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material

submitted in support of the request for rulings, it is subject to verification on examination.

A copy of this letter must be attached to any income tax return to which it is relevant.

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

Sincerely yours,
Associate Chief Counsel (Corporate)

By: Steven J. Hankin

Steven J. Hankin
Senior Technical Reviewer, Branch 6 (Corporate)