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Department of the Treasury

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Date:

December 10, 2002

LEGEND

Distributing =

Trust A =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Business A =

State X =

Year A =

A% =

B% =

C% =

D% =

E% =

A# =

PLR-147500-02

B# =

C# =

D# =

E# =

Dear :

This letter responds to your August 12, 2002 request for rulings on certain federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated October 15, 2002, November 7, 2002, November 22, 2002, and December 4, 2002. The information submitted for consideration is summarized below.

Facts

Distributing is a State X corporation incorporated in Year A and has engaged in Business A since its formation. Distributing is a calendar year, non-public, subchapter C corporation that uses the cash method of accounting. Distributing is not a member of an affiliated member of a group filing consolidated returns.

Since its formation, Distributing has had only one class of authorized, issued and outstanding stock. A# shares of Distributing stock are outstanding. The outstanding shares are held as follows: (1) Trust A (a trust held for the benefit of Shareholder A, Shareholder B, Shareholder C and Shareholder D) directly holds B# shares representing A% of Distributing; (2) Excluding any ownership attributable to the beneficiaries from Trust A, Shareholder A, Shareholder B, Shareholder C and Shareholder D will each directly own C# shares of Distributing representing a total of B% of the stock of Distributing. Prior to the proposed transaction, the B# shares held by Trust A will be distributed to the beneficiaries of the trust. Distributing has no security holders.

Following the distribution from the trust and prior to the proposed transaction, the A# outstanding shares of Distributing stock will be held as follows: (1) Shareholder A will own D# shares representing C% of Distributing; (2) Shareholder B, Shareholder C and Shareholder D will each own E# shares (D% of the shares) representing a total of E% of the ownership of Distributing.

PLR-147500-02

Proposed Transaction

The shareholders of Distributing have had continuing disputes and disagreements between each other with respect to the management and operation of Business A as conducted in Distributing. These disputes adversely affect the normal operations of the business. The shareholders have decided to engage in a split-off so that the shareholders may each go their separate way. To effect the separation of Business A, Distributing proposes the following Transaction:

Distributing will form three wholly owned subsidiary corporations: Controlled 1; Controlled 2; and Controlled 3 (sometimes hereinafter referred to together as "Controlled Corporations") that will be incorporated in State X. Distributing will transfer assets and liabilities of Distributing to each of the three Controlled Corporations. The assets and liabilities transferred to each of the Controlled Corporations will be equal to D% of the value of Distributing prior to the transfer. All of the stock (and solely stock) of Controlled 1, Controlled 2 and Controlled 3 will be issued to Distributing.

Distributing will transfer: (1) the Controlled 1 stock to Shareholder B; (2) Controlled 2 stock to Shareholder C; and (3) Controlled 3 stock to Shareholder D in exchange for all of their Distributing stock. Shareholder A will hold all of the Distributing stock after the split-off.

Following the transaction, neither Controlled 1, Controlled 2 nor Controlled 3 will be indebted to Distributing.

Representations

The following representations are made with respect to the Proposed Transaction:

- (a) Distributing and Controlled 1 and their respective shareholders will each pay their own expenses, if any, incurred in connection with the transaction.
- (b) Distributing and Controlled 2 and their respective shareholders will each pay their own expenses, if any, incurred in connection with the transaction.
- (c) Distributing and Controlled 3 and their respective shareholders will each pay their own expenses, if any, incurred in connection with the transaction.
- (d) The fair market value of the Controlled 1, Controlled 2 and Controlled 3 stock to be received by each of the respective shareholders of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.

PLR-147500-02

- (e) 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.
- (f) The 5 years of financial information submitted on behalf of Distributing 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.
- (g) Following the transaction, Distributing, Controlled 1, Controlled 2 and Controlled 3 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 prior to consummation of the transaction.
- (h) The distributions of the stock of the Controlled 1, Controlled 2 and Controlled 3 will be carried out to eliminate shareholder disputes that, if permitted to continue, would jeopardize the operation and continued success of the corporate business.

The distribution of the stock of the Controlled Corporations is motivated, in whole or substantial part, by this corporate business purposes.

- (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, or securities of, either Distributing, Controlled 1, Controlled 2 or Controlled 3 after the transaction except for transfers by gift to family members of the transferor for no consideration.
- (j) Distributing is a C corporation. The Controlled Corporations do not plan to elect S corporation status.

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

- (k) There is no plan or intention by either Distributing or the Controlled Corporations, 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, 1996-1 C.B. 696, 705.
- (l) There is no plan or intention to liquidate either Distributing, Controlled 1, Controlled 2 or Controlled 3, to merge any of these corporations with any other corporation, or to sell or otherwise dispose of the assets of any of these corporations after the distributions, except in the ordinary course of business.

PLR-147500-02

- (m) The total adjusted basis and the fair market value of the assets transferred to Controlled 1 in the Controlled 1 transfer, Controlled 2 in the Controlled 2 transfer, and Controlled 3 in the Controlled 3 transfer by Distributing in the transaction will, in each instance, equal or exceed the sum of the liabilities assumed (as determined under section 357(d)) by Controlled 1, Controlled 2 and Controlled 3, respectively.
- (n) The liabilities assumed (as determined under section 357(d)) in the Controlled 1 transfer, Controlled 2 transfer and the Controlled 3 transfer were incurred in the ordinary course of business and are associated with the assets being transferred.
- (o) The income tax liability for the taxable year in which investment credit property (including any building to which section 47(d) applies) is transferred will be adjusted pursuant to section 50(a)(1) or (a)(2) (or section 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
- (p) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (q) No intercorporate debt will exist between Distributing, Controlled 1, Controlled 2 and Controlled 3 at the time of, or subsequent to, the distribution of the Controlled Corporation's stock.
- (r) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (s) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled Corporations will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (t) The gross assets of the trades or businesses relied on to satisfy the active business requirement of section 355(b) will have a fair market value that is 5 percent or more of the total fair market value of the gross assets of the corporation directly conducting the trades or businesses.
- (u) For purposes of section 355(d), immediately after the Distributions no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in

PLR-147500-02

section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of each distribution.

- (v) For purposes of section 355(d), immediately after the Distributions no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Controlled 1, Controlled 2 or Controlled 3 entitled to vote, or 50 percent or more of the total value of shares of all classes of stock of said corporations, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the distribution.
- (w) The distributions are not part of a plan or series of related transactions (within the meaning of section 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 of either Distributing, Controlled 1, Controlled 2 or Controlled 3, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing, Controlled 1, Controlled 2 or Controlled 3.

Rulings

Based on the information submitted and the representations made, it is held as follows:

- (1) The transfer by Distributing to Controlled Corporations of the assets associated with its Business A solely in exchange for all of the outstanding Controlled 1, Controlled 2 and Controlled 3 voting stock and the assumption of liabilities, followed by the distribution of all the Controlled 1, Controlled 2 and Controlled 3 voting stock to Distributing's shareholders in exchange for stock in Distributing, as described above, will be a reorganization within the meaning of section 368(a)(1)(D). Distributing, Controlled 1, Controlled 2 and Controlled 3 will each be "a party to a reorganization" within the meaning of section 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of the Distributing assets to Controlled 1 in exchange for Controlled 1 stock and the assumption of liabilities by Controlled 1 of Distributing's liabilities, as described above (sections 361(a) and 357(a)).
- (3) Distributing will recognize no gain or loss upon the transfer of the Distributing assets to Controlled 2 in exchange for Controlled 2 stock and the assumption of

PLR-147500-02

liabilities by Controlled 2 of Distributing's liabilities, as described above (sections 361(a) and 357(a)).

- (4) Distributing will recognize no gain or loss upon the transfer of the Distributing assets to Controlled 3 in exchange for Controlled 3 stock and the assumption of liabilities by Controlled 3 of Distributing's liabilities, as described above (sections 361(a) and 357(a)).
- (5) Controlled 1, Controlled 2 and Controlled 3 will recognize no gain or loss on the receipt of assets and liabilities of Distributing in exchange for the Controlled 1, Controlled 2 and Controlled 3 stock, as described above (section 1032(a)).
- (6) Controlled 1, Controlled 2 and Controlled 3's basis of the assets received will be the same as the basis of such assets in the hands of Distributing immediately prior to the exchange (section 362(b)).
- (7) Controlled 1, Controlled 2 and Controlled 3's holding period for each asset received from Distributing will include the period during which such assets were held by Distributing (section 1223(2)).
- (8) No gain or loss will be recognized to (and no amount will be included in the income of) the shareholders of Distributing upon their receipt of the stock of Controlled 1, Controlled 2 and Controlled 3, as the case may be, in exchange for their Distributing stock (section 355(a)(1)).
- (9) The holding period of the Controlled 1, Controlled 2 and Controlled 3 stock received by the Distributing shareholders will include the holding period of their Distributing stock with respect to which the distribution is made, provided that the Distributing stock is held as a capital asset on the date of distribution (section 1223(1)).
- (10) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled 1, Controlled 2 and Controlled 3 will be made in accordance with section 1.312-10(a).
- (11) No gain or loss will be recognized to Distributing upon the distribution of its stock in Controlled 1, Controlled 2 and Controlled 3 to its shareholders (section 361(c)(1) and section 355(c)(1)).
- (12) The basis of Controlled 1, Controlled 2 and Controlled 3 stock in the hands of each respective controlling shareholder: Shareholder B, Shareholder C and Shareholder D, after the distribution, will equal the basis of the Distributing stock surrendered by each such shareholder in exchange therefor (section 358(a)(1)).

PLR-147500-02

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

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

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

The rulings contained in this letter are based upon information and representations submitted by the taxpayer 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.

Sincerely,

Steven J. Hankin

Steven J. Hankin
Senior Technician Reviewer, Branch 6
Office of Chief Counsel (Corporate)

cc: