

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

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Refer Reply To:

**CC:CORP:4 PLR-146228-02**

Date:

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### Legend

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Business A =

Business B =

Business C =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

a =

Dear :

This letter responds to your August 14, 2002 request for rulings regarding certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

### **Summary of Facts**

Distributing is engaged in Business A and has voting common and nonvoting common stock outstanding (the "Distributing Voting Stock" and the "Distributing Nonvoting Stock", respectively, and collectively, the "Distributing Stock"). The Distributing Voting Stock is owned by A, while the Distributing Nonvoting Stock is owned by B, C, D, E, F, G, H, I, and J. A is a revocable trust. Under the terms of the trust agreement governing A, neither B, C, D, or E can acquire any of A's Distributing Voting Stock after the Distribution (as defined below). J is the estate of the late K. Under the documents governing J, neither B, C, D, or E can acquire any Distributing Nonvoting Stock owned by J after the Distribution.

Distributing wholly owns Controlled, Sub 1, and Sub 2, and as common parent, files a consolidated return on behalf of these subsidiaries. Controlled is engaged in Business B and has voting common and nonvoting common stock outstanding (the "Controlled Voting Stock" and the "Controlled Nonvoting Stock", respectively, and collectively, the "Controlled Stock"). Sub 1 and Sub 2 are both engaged in Business C and before the closing of the Proposed Transaction (as defined below), Sub 1 will be liquidated (the "Liquidation"). B, who currently serves as a director of Sub 2, will relinquish this board position simultaneous with the effective date of the Distribution.

Financial information has been submitted which indicates that Distributing and Controlled each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

### **Proposed Transaction**

To eliminate disagreements among the shareholders regarding the future direction of Distributing, Controlled and Sub 2, and to allow B, C, D, and E the opportunity to devote their undivided attention to Controlled's business without interference from the remaining Distributing shareholders who are only interested in the businesses of Distributing and Sub 2, the following series of steps have been proposed (collectively, the "Proposed Transaction"):

- (i) Distributing will transfer certain Business B assets to Controlled in constructive exchange for additional Controlled stock (the "Contribution").
- (ii) Controlled will borrow approximately a dollars from unrelated third parties and will distribute these proceeds (the "Proceeds") to Distributing in order to equalize the values between Distributing and Controlled. Distributing will transfer all of the Proceeds to its creditors in connection with its reorganization.
- (iii) Distributing will distribute its Controlled Voting Stock and Controlled Nonvoting Stock to B, C, D, and E in proportion to their existing stock ownership in Distributing (the "Distribution"). B, C, D, and E will surrender all of their Distributing Nonvoting Stock in exchange for the Controlled Stock in the Distribution.

### **Representations**

The taxpayer has made the following representations regarding the Proposed Transaction:

- (a) The fair market value of the Controlled Stock received by B, C, D, and E will approximately equal the fair market value of the respective Distributing Nonvoting Stock surrendered by these shareholders in the exchange.

(b) No part of the consideration distributed by Distributing will be received by a shareholder as a creditor, employee, or in any other capacity other than that of a Distributing shareholder.

(c) The five years of financial information submitted on behalf of Distributing and Controlled represents the present operations of these corporations, and there have been no substantial operational changes to these corporations since the date of the last submitted financial statements.

(d) Following the Distribution, Distributing and Controlled will each continue the active conduct of its respective business, independently and with its own employees.

(e) The Distribution will (i) eliminate shareholder disagreements as to the future direction of the businesses of Distributing, Controlled, and Sub 2, and (ii) allow certain Distributing shareholders to own and operate Controlled's business without interference from the remaining Distributing shareholders who are only interested in owning and operating the businesses of Distributing and Sub 2. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(f) The difference between the total adjusted basis of the assets to be transferred by Distributing to Controlled in the Contribution and the Proceeds will not exceed Distributing's adjusted basis in its Controlled stock at the time of the Contribution. As a result, Distributing, which currently does not have an excess loss account in its Controlled stock, will not have such an account after the Contribution and receiving the Proceeds. Controlled will not assume any liabilities of Distributing in connection with the Contribution, and the assets that Controlled will receive from Distributing in the Contribution will not be subject to any liabilities.

(g) There is no plan or intention by the shareholders of either Distributing or Controlled to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing or Controlled after the Proposed Transaction, except that certain shareholders of Distributing may gift shares of their Distributing Stock to other family members who are also Distributing shareholders, and certain Controlled shareholders may gift shares of their Controlled Stock to family members who are also Controlled shareholders. However, no Distributing shareholder will transfer (by sale, gift, exchange, or otherwise) any of their Distributing Stock to any Controlled shareholder after the Proposed Transaction, and no Controlled shareholder will transfer (by sale, gift, exchange, or otherwise) any of their Controlled Stock to any Distributing shareholder after the Proposed Transaction.

(h) 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 Proposed 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.

(i) 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 Proposed Transaction, except in the ordinary course of business.

(j) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.

(k) No two parties to the Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(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, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, any excess loss account Distributing may have in Controlled stock will be included in income immediately before the Distribution to the extent required by applicable regulations (see § 1.1502-19).

(m) To the extent any transfer in the Proposed Transaction results in an early disposition of property for which an investment credit has been (or will be) claimed under § 46, the income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable)) to reflect the early disposition of the property.

(n) B, C, D, and E will not acquire any Distributing Stock after the Proposed Transaction. B, C, D, and E will not be shareholders, employees, officers, or directors of Distributing or Sub 2 after the Proposed Transaction. A, F, G, H, I, and J will not acquire any Controlled Stock after the Proposed Transaction. A, F, G, H, I, and J will not be shareholders, employees, officers, or directors of Controlled after the Proposed Transaction.

(o) There will be no continuing transactions between Distributing and Controlled after the Proposed Transaction. There will be no continuing transactions between Controlled and Sub 2 after the Proposed Transaction.

(p) The Distribution is 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 percent or more of the total combined voting power of all classes of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

(q) Distributing will not retain any of the Proceeds that it will receive from

Controlled in the Proposed Transaction. Rather, Distributing will transfer all of the Proceeds to its creditors pursuant to the plan of reorganization.

(r) Controlled will not transfer any assets (other than the Proceeds) to Distributing in the Proposed Transaction.

(s) Distributing is not an S corporation (under § 1361(a)), and neither Distributing nor Controlled expects or plans to make an S corporation election under § 1362(a) after the Proposed Transaction.

(t) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 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 §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(u) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 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 §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

### **Rulings**

Based solely on the information submitted and the representations made, we rule as follows regarding the Proposed Transaction:

(1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" under § 368(b).

(2) No gain or loss will be recognized by Distributing on the Contribution (§ 361(a) and § 361(b)(3)).

(3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).

(4) The basis that Controlled has in each asset received from Distributing will equal the basis of that asset in the hands of Distributing immediately before the

Contribution (§ 362(b)).

(5) The holding period for each asset received by Controlled in the Contribution will include the period during which Distributing held that asset (§ 1223(2)).

(6) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) B, C, D, or E upon their receipt of the Controlled Stock in exchange for their Distributing Nonvoting Stock (§ 355(a)(1)).

(7) The aggregate basis of the Controlled Stock in the hands of B, C, D, and E after the Distribution will, in each instance, equal the aggregate basis of the respective Distributing Nonvoting Stock surrendered by the shareholder in the exchange (§ 358(a)(1)).

(8) The holding period of the Controlled Stock received by B, C, D, and E will, in each instance, include the holding period of the respective Distributing Nonvoting Stock surrendered by the shareholder, provided such stock is held as a capital asset on the date of the exchange (§ 1223(1)).

(9) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)).

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

### **Caveats**

No opinion is expressed about the 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. In particular, no opinion is expressed as to the federal income tax consequences of the Liquidation.

### **Procedural Statements**

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

Each taxpayer affected by the Proposed Transaction should attach a copy of this ruling letter to its, his, or her federal income tax return for the taxable year in which the Proposed Transaction is completed.

Under a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

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Richard K. Passales  
Senior Counsel, Branch 4  
Office of Associate Chief Counsel  
(Corporate)