

Internal Revenue Service

Department of the Treasury

Index Number: 355.01-01

Washington, DC 20224

Number: **200022044**
Release Date: 6/2/2000

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP:5-PLR-101762-00
Date:
March 7, 2000

Distributing =

Controlled =

State X =

Business A =

A =

B =

C =

D =

a =

b =

c =

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Dear _____ :

We reply to your letter dated October 29, 1999, in which you requested rulings as to the federal income tax consequences of a proposed transaction. Additional information was received in subsequent submissions. The information submitted for consideration is substantially as set forth below.

Distributing is a State X corporation engaged in Business A. Distributing has outstanding a shares of voting common stock that are owned in equal parts by four siblings (Shareholders A, B, C, and D).

Controlled will be a State X corporation formed to effectuate the proposed transaction. Controlled will have issued and outstanding b shares of voting common stock, all of which initially will be held by Distributing.

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

Because of management disagreements between D and the other sibling shareholders, the shareholders have decided to divide D's share of Distributing's business assets and allow her to go her separate way. Accordingly, Distributing proposes the following transaction:

- (i) Distributing will transfer to the newly-formed Controlled approximately c percent of its business assets, plus cash. In exchange, Distributing will receive all of the issued and outstanding shares of Controlled voting common stock. Controlled will neither assume any liabilities nor receive any assets subject to liabilities from Distributing.
- (ii) Thereafter, Distributing will distribute all of the shares of Controlled stock to D in exchange for all of her shares of Distributing stock.

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) The fair market value of the stock of Controlled received by D, described in step (ii) above, will approximately equal the fair market value of the Distributing stock surrendered by D in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by any person as a creditor, employee, or in any capacity other than as a shareholder of the corporation.

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- (c) The five years of financial information submitted on behalf of Distributing represents Distributing's present operations, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the proposed transaction, Distributing and Controlled each will continue, independently and with their separate employees, the active conduct of the business previously conducted solely by Distributing.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purpose: management disagreements and irreconcilable differences between shareholders which have an adverse effect on the operations of Distributing. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) 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 subsequent to the transaction.
- (g) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary, 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 Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation subsequent to the transaction, except in the ordinary course of business.
- (i) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the proposed distribution.
- (k) There are no planned continuing transactions between Distributing and Controlled. However, payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be at fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (l) Neither Distributing nor Controlled is an "investment company" as defined in § 368(a)(2)(F)(iii) and (iv) of the Internal Revenue Code.

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- (m) Distributing is not an S corporation within the meaning of § 1361(a), and there is no plan or intention by either Distributing or Controlled 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 to Controlled of the assets and cash, as described in step (i) above, solely in exchange for all of the outstanding stock of Controlled, followed by the distribution of the Controlled stock by Distributing to D in exchange for all of her Distributing stock will be a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled each will be a “party to a reorganization” within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing upon the transfer of assets and cash to Controlled in exchange for Controlled stock (§ 361(a)).
- (3) No gain or loss will be recognized by Controlled upon the receipt of the assets and cash in exchange for Controlled stock (§ 1032(a)).
- (4) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the proposed transaction (§ 362(b)).
- (5) The holding period of the Distributing assets received by Controlled will include the period during which such assets were held by Distributing (§ 1223(2)).
- (6) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of Controlled. (§ 361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder D upon the receipt of the Controlled stock in exchange for all of her stock in Distributing. (§ 355 (a)(1)).
- (8) Shareholder D’s basis in the Controlled stock after the distribution will be the same as her basis in the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).
- (9) Shareholder D’s holding period in the Controlled stock received will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital

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asset by Shareholder D on the date of the exchange (§ 1223(1)).

- (10) 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.

We express no opinion about the tax treatment of the 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 proposed transaction that are not specifically covered by the above rulings.

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

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Pursuant to a power of attorney on file in this office, a copy of this letter has been sent to your authorized representatives.

Sincerely,

Assistant Chief Counsel (Corporate)

By: Filiz A. Serbes

Filiz A. Serbes

Assistant to the Chief, Branch 5