

## Internal Revenue Service

## Department of the Treasury

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Date:

**June 12, 2003**

### Legend

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Business A =

Percent 1 =

Percent 2 =

Percent 3 =

Percent 4 =

State A =

Dear

This is in response to your letter dated February 5, 2003, requesting rulings under § 355 of the Internal Revenue Code (the "Code") with respect to a proposed transaction. Additional information was received in letters dated March 28, May 9, and June 5, 2003. The material information submitted is summarized below.

Distributing is a State A corporation that files its federal income tax return on a calendar year basis using the accrual method of accounting. Distributing has a single class of stock and no securities outstanding. The stock of Distributing is owned 44.2% by Shareholder A and 25.4% by Shareholder B among others.

Distributing is engaged in Business A. Financial information has been received indicating that Business A has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five years. In an attempt to minimize disputes between Shareholder A and Shareholder B that were adversely affecting Distributing's business, and achieve differing business growth objectives of Shareholder A and Shareholder B, Distributing proposes the following steps to implement a corporate division of Business A.

1. Distributing will form a subsidiary, Controlled, and will contribute to Controlled certain assets of Business A in exchange for all of the stock of Controlled and the assumption by Controlled of certain Distributing liabilities.
2. Distributing will distribute 96.4% of the stock of Controlled to Shareholder B in exchange for all of Shareholder B's Distributing stock, and 1.2% each for each of shareholders C, D and E in exchange for all of their stock of Distributing (the "Distribution").

Distributing has made the following representations with respect to the proposed series of transactions:

- (a) The fair market value of the Controlled stock and other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.
- (b) 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.
- (c) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employee(s), the active conduct of its share of all the integrated activities of the business conducted by Distributing prior thereto.

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(d) The Distribution of the stock of Controlled is carried out for the following corporate business purposes: (1) to eliminate disputes between the two principal shareholders over management goals and practices; (2) to eliminate disagreement that could result in the shareholders being unable to pursue these business operations. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of the corporate business purposes.

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

(f) 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 transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

(g) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operations, and with regard thereto, there have been no substantial operational changes since the date of the last financial statement submitted.

(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 after the transaction, except in the ordinary course of business.

(i) The total adjusted bases and fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled 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) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.

(l) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(m) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

(n) No Distributing shareholder or shareholders will hold immediately after the Distribution disqualified stock within the meaning of section 355(d)(3), which constitutes a 50% or greater interest in Distributing or Controlled.

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(o) The Distribution is not a 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 fifty percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing fifty percent or more of the total value of all classes of stock of either Distributing or Controlled.

(p) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the transaction.

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

(r) Distributing and Controlled will each pay its own expenses of the proposed transaction.

(s) Following the proposed transaction, neither Distributing nor Controlled will guarantee, collateralize, or accommodate in any way, any debt of the other corporation.

Based solely on the information provided and the representations made, we conclude as follows:

(1) The transfer of certain Business A assets by Distributing to Controlled in exchange for all the stock of Controlled and the assumption of certain Distributing liabilities described above, followed by the distribution of all of the Controlled stock to Shareholders B, C, D and E in exchange for all of the Distributing stock owned by these Shareholders will be a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be a "party to the reorganization" within the meaning of section 368(b).

(2) No gain or loss will be recognized by Distributing upon the transfer of certain Business A assets to Controlled in exchange for the Controlled stock and assumption of certain Distributing liabilities as described above (sections 361(a) and 357(a)).

(3) No gain or loss will be recognized by Distributing upon the distribution of all the stock of Controlled (section 361(c)(1)).

(4) No gain or loss will be recognized by Controlled upon the receipt of the assets and liabilities of Business A in exchange for all the shares of the Controlled stock (section 1032(a)).

(5) The basis of each of the assets to be received by Controlled in the transaction will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (section 362(b)).

(6) The holding period of each of the assets to be received by Controlled will include the period during which Distributing held such assets (section 1223(2)).

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(7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholders B, C, D, and E upon the receipt of Controlled stock in exchange for their Distributing stock, respectively (section 355(a)(1)).

(8) The basis of the Controlled stock to be received by Shareholders B, C, D and E will be the same as the basis of the Distributing stock surrendered in exchange therefore (section 358(a)(1)).

(9) The holding period of the Controlled stock to be received by Shareholders B, C, D and E will include the holding period of the Distributing stock surrendered by such shareholders in exchange therefor provided that the Distributing stock is held as a capital asset on the date of the exchange (section 1223(1)).

(10) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under section 1.312-10(a).

No opinion is expressed as to the tax treatment of the transaction under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above ruling.

In accordance with a power of attorney on file in this office, copies of this letter are being sent to the authorized party.

A copy of this letter must be attached to the federal income tax return of the taxpayers involved for the taxable year in which the transaction is consummated.

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

Sincerely,

*Alison Burns*

Alison Burns  
Acting Assistant Branch Chief, Branch 2  
Office of Associate Chief Counsel, Corporate

cc: