

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

Person to Contact:

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Refer Reply To:

**CC:CORP:B02-PLR-109945-00**

Date:

August 30, 2000

### LEGEND:

Distributing =

Controlled =

Shareholder 1 =

Shareholder 2 =

Business A =

Business B =

State X =

Y% =

Z% =

Dear:

This letter responds to your letter dated May 9, 2000, in which you requested, on behalf of the above referenced taxpayer, rulings under section 355 of the Internal Revenue Code. Additional information regarding your request has been submitted in letters dated June 23 and August 23, 2000. The material information submitted for consideration is summarized below.

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Distributing, a State X Subchapter S corporation, files its federal income tax return on a calendar year basis and uses the accrual method of accounting. Distributing has only one class of outstanding common stock. Shareholder 1 owns Y% of the outstanding common stock, and Shareholder 2 owns Z% of the outstanding common stock. Distributing is engaged directly in Business A and in Business B. Both Business A and Business B have been conducted for more than five years.

Controlled will be a State X corporation and will be formed for the purpose of independently operating Business B. Controlled intends to elect Subchapter S status on the first available date after consummation of the proposed transaction. Controlled will file its federal income tax returns on a calendar year basis and will use the accrual method of accounting.

The taxpayer has supplied financial information which indicates that Distributing has been conducting Business A and Business B and that each has had gross receipts and operating expenses representative of the active conduct of such business for each of the past five years.

In recent years, the shareholders of Distributing have differed on a number of business issues including diversification of the business inventory, proper marketing strategy, and expansion of the businesses. In addition, Shareholder 1 is predominantly interested in Business A, and Shareholder 2 is predominantly interested in Business B. Due to the continuing shareholder disputes and their divergent interests, Shareholder 1 and Shareholder 2 have proposed to separate the businesses of Distributing.

Accordingly, Distributing has proposed the following transaction. First, Distributing will form Controlled and will transfer all of the Business B assets to Controlled in exchange for all of the issued and outstanding stock of Controlled. The assets transferred will constitute Z% of the assets of Distributing. Distributing will then distribute all of the issued and outstanding stock of Controlled to Shareholder 2 in exchange for all of Shareholder 2's shares of Distributing stock. Shareholder 1 will be the sole remaining shareholder of Distributing.

The following additional representations have been made in connection with the proposed transaction:

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

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- (c) The five years of financial information submitted on behalf of Distributing is representative of its present operations, 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 proposed transaction, Distributing and Controlled will each continue the active conduct of its respective business, independently and with its separate employees.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purposes: (i) resolution of shareholder disputes, and (ii) allowing the individual shareholders to separately manage their respective businesses. The distribution of Controlled stock is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) Distributing is an S corporation (within the meaning of section 1361(a)). Controlled will elect to be an S corporation pursuant to section 1362(a) on the first available date after the distribution, and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.
- (g) There is no plan or intention on by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing or Controlled 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 transaction, other than through stock purchases meeting the requirements of Section 4.05(1)(b) of *Rev. Proc. 96-30*.
- (i) Distributing and Controlled have no accumulated earnings and profits at the beginning of their respective taxable years.
- (j) Distributing and Controlled will have no current earnings and profits as of the date of the distribution.
- (k) No distribution of property by Distributing immediately before the transaction would require recognition of gain resulting in current earnings and profits for the taxable year of the distribution.
- (l) Distributing is not aware of, nor is it planning or intending, any event that will result in Distributing or Controlled having positive current or accumulated earnings and profits after the distribution.

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- (m) 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 any of the assets of either corporation subsequent to the proposed transaction, except in the ordinary course of business.
- (n) The total adjusted bases and the 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.
- (o) 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.
- (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 and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (r) 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 determined by the parties bargaining at arm's length.
- (s) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (t) No Distributing shareholder will hold immediately after the distribution disqualified stock within the meaning of § 355(d)(3) which constitutes a 50% or greater interest in Distributing or Controlled.
- (u) 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% or more of the combined voting power of all classes of stock entitled to vote of either Distributing or Controlled, or stock possessing 50% or more of the total value of all classes of stock of either Distributing or Controlled.

Based solely upon the information submitted and the representations made, we rule as follows:

- (1) The transfer by Distributing to Controlled of a portion of the assets of its business, solely in exchange for all of the issued and outstanding stock of

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Controlled, followed by the distribution of all of the stock of Controlled to Shareholder 2 in exchange for all of the Distributing stock owned by Shareholder 2, will be a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled 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 assets to Controlled in exchange for the stock of Controlled. Sections 361(a) and 357(a).
- (3) Controlled will recognize no gain or loss upon the receipt of the assets from Distributing in exchange for the stock of Controlled. Section 1032(a).
- (4) The basis of the assets received by Controlled in the transaction will be the same as the basis of such assets in the hands of Distributing immediately prior to their transfer to Controlled. Section 362(b).
- (5) The holding period of the Distributing assets received by Controlled in the transaction will include the period during which such assets were held by Distributing. Section 1223(2).
- (6) Shareholder 2 will recognize no gain or loss (and no amount will be included in the income of Shareholder 2) upon the receipt of Controlled stock in exchange for all of the Distributing stock held by Shareholder 2. Section 355(a)(1).
- (7) Distributing will recognize no gain or loss upon the distribution of the Controlled stock to Shareholder 2 in exchange for Shareholder 2's stock in Distributing. Section 361(c).
- (8) The basis of the stock of Controlled in the hands of Shareholder 2 will be the same as the basis of the Distributing stock surrendered by Shareholder 2 in exchange therefor. Section 358(a)(1).
- (9) The holding period of the Controlled stock received by Shareholder 2 will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset on the date of the exchange. Section 1223(1).

No opinion is expressed or implied about the tax treatment of the proposed 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.

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This ruling letter is directed only to the taxpayer(s) requesting 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 return(s) of the taxpayer(s) involved for the taxable year in which the transaction covered by this ruling letter is consummated.

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

Sincerely yours,

Associate Chief Counsel  
(Corporate)

(by)

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Lewis K Brickates  
Assistant to the Chief, Branch 2  
(Corporate)