

Internal Revenue Service

Department of the Treasury

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CC:CORP:B05-PLR-125548-02

Date:

September 5, 2002

In Re:

LEGEND:

Distributing =

Controlled =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Shareholder 6 =

Shareholder 7 =

Shareholder 8 =

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Shareholder 9 =

Shareholder 10 =

Shareholder 1 Group =

Shareholder 6 Group =

Director 1 =

Director 2 =

A =

B =

State X =

City 1 =

City 2 =

Date 1 =

Date 2 =

Date 3 =

Year 1 =

Year 2 =

Year 3 =

a =b =c =

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d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

n =

Dear :

This letter responds to a request for a private letter ruling dated May 2, 2002 submitted by you on behalf of Distributing with respect to certain federal income tax consequences of a proposed transaction. Additional information was received in letters dated June 26, 2002, August 19, 2002 and August 28, 2002. The rulings in this letter are based on the facts and representations submitted under penalties of perjury in support of the request. Verification of that information may be required as part of the audit process. The material information is summarized below.

Distributing is a State X corporation that was incorporated on Date 1 (more than 5 years ago). From Year 1 through Year 2, Distributing was engaged in the A business. In Year 2, Distributing discontinued it's A business and began to engage in the B business in the area surrounding City 1. From Year 1 to Year 3, Director 1 served as an officer and director of Distributing, was the majority shareholder of Distributing, and managed Distributing's B business. Director 2 also served as an officer and director of Distributing, was a shareholder of Distributing and primarily conducted clerical services for Distributing.

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By Year 3, Director 1 and Director 2 had transferred all of their shares of Distributing stock to the Shareholder 1 Group and the Shareholder 6 Group. Shareholder 1 served as a director and officer of Distributing, as did Director 1 and Director 2. The Shareholder 1 Group includes: Shareholder 1, owning a% of Distributing stock; Shareholder 2 owning b% of Distributing stock; Shareholder 3, owning c% of Distributing stock; Shareholder 4, owning b% of Distributing stock; and Shareholder 5, owning c% of Distributing stock. The Shareholder 6 Group includes: Shareholder 6, owning a% of Distributing stock; Shareholder 7, owning d% of Distributing stock; Shareholder 8, owning e% of Distributing stock; Shareholder 9, owning f% of Distributing stock; and Shareholder 10, owning g% of Distributing stock.

In Year 3, differences arose between Shareholder 1 and Shareholder 6 over the focus and direction for Distributing's B business. In an effort to resolve these differences, Distributing incorporated Controlled as a State X corporation, and on Date 2, transferred approximately h% of its B business assets in exchange for i shares of Controlled stock. Shareholder 6, Director 1 and Director 2 were elected as the officers and directors of Controlled.

However, by Year 4 it became apparent that Shareholder 1 and Shareholder 6 could no longer operate the B businesses of Distributing and Controlled within the same corporate group. In order to allow Shareholder 1 and Shareholder 6 to separately operate the B businesses of Distributing and Controlled, the shareholders of Distributing wish to distribute all of Distributing's Controlled stock to the Shareholder 6 Group in exchange for all of their Distributing stock. Shareholder 6 will receive j%, Shareholder 7 will receive k%, Shareholder 8 will receive l%, Shareholder 9 will receive m%, and Shareholder 10 will receive n% of the stock in Controlled.

Financial documentation has been submitted which indicates that the B business conducted by Distributing has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years. In addition, financial documentation has been submitted which indicates that the B business conducted by Controlled has had gross receipts and operating expenses representing the active conduct of a trade or business since Date 2.

In connection with the transaction, it has been represented that:

- (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 each 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.

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- (c) The gross assets of Distributing used in the B business have a market value which is in excess of five percent (5%) of its gross assets, and after the proposed transaction, the gross assets of Distributing and Controlled which are used in the B business will have a fair market value which is in excess of five percent (5%) of each of Distributing and Controlled's gross assets.
- (d) The 5 years of financial information submitted on behalf of Distributing is representative of the corporation's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) The gross assets of Controlled used in the B business have a market value which is in excess of five percent (5%) of its gross assets, and after the proposed transaction, the gross assets of Distributing and Controlled which are used in the B business will have a fair market value which is in excess of five percent (5%) of each of Distributing and Controlled's gross assets.
- (f) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (g) The distribution of the stock of Controlled will be carried out for the following business purpose: To separate the management of the B business among the shareholders of Distributing to resolve management problems. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (h) Distributing is not an S Corporation (within the meaning of § 1361(a)) and there is no plan or intentions by Distributing or Controlled to make an S corporation election pursuant to § 1362(a).
- (i) 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 stock in, or securities of, Distributing or Controlled after the proposed transaction.
- (j) 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.

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- (k) There is no plan or intention to liquidate Distributing or Controlled or to merge any of those corporations 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.
- (l) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing equals or exceeds the sum of the liabilities assumed (as determined under § 357(d)) by Controlled, plus any liabilities to which the transferred assets are subject.
- (m) The liabilities assumed (as determined under § 357(d)) in the proposed 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.
- (n) The income tax liability for the taxable year in which the investment credit property, if any (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.
- (o) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the proposed transaction.
- (p) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the proposed transaction.
- (q) 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.
- (r) No two parties to the proposed transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (s) 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 (except as allowed by section 355(e)) directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock 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.
- (t) Following the proposed transaction, no person will hold disqualified stock

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(within the meaning of § 355(d)(3)) in either Distributing or Controlled, which constitutes a 50 percent or greater interest (within the meaning of § 355(d)(4)) in such corporation.

- (u) Director 1 and Director 2 will cease to serve as directors and officers of both Distributing and Controlled as of the date that the proposed transaction is complete.
- (v) Distributing, Controlled, and the shareholders of Distributing will each pay their own expenses, if any, incurred in connection with the proposed transaction.
- (w) The cash and investment assets held by Distributing and held by Controlled are related to the reasonable needs of the conduct of the active trade or business of each corporation.

Based solely on the information submitted and the representations set forth above, we rule as follows regarding the transaction:

- (1) No gain or loss will be recognized by Distributing upon the distribution of all of its Controlled stock to the shareholders comprising the Shareholder 6 Group in exchange for all of their Distributing stock (§ 361(c)(1)).
- (2) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the shareholders comprising the Shareholder 6 Group upon the receipt of the Controlled stock in exchange for all of their Distributing stock (§ 355(a)(1)).
- (3) The holding period of the Controlled stock received by the shareholders comprising the Shareholder 6 Group will include the holding period of the Distributing stock with respect to which the distribution will be made, provided the Distributing stock is held as a capital asset on the date of the distribution (§ 1223(1)).
- (4) The basis of the Controlled stock in the hands of the shareholders comprising the Shareholder 6 Group after the distribution will equal the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

No opinion is expressed about the tax treatment of the transaction under any other provision 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 in the above rulings.

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

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

Pursuant to a power of attorney on file in this office, a copy of this letter is being sent to Distributing.

Sincerely,

Debra L. Carlisle
Chief, Branch 5
Office of Associate Chief Counsel
(Corporate)

cc: