

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Legend

Distributing =

Controlled =

State N =

A =

B =

C =

D =

Business Y =

PLR-134322-02

Year 1 =

w =

x =

y =

z =

Dear :

We respond to a letter dated June 19, 2002, requesting rulings on the Federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated August 22, September 11, and September 30, 2002. The information submitted for consideration is summarized below.

Distributing is a State N corporation that uses the cash method of accounting. Distributing has w shares of voting common stock outstanding which are owned by A (x shares), B (y shares (approximately 0.02 percent), and C, a trust, (z shares). A is the of Distributing's founder and the of D. D is the sole income beneficiary of C and the only child of Distributing's founder.

Controlled will be a State N corporation to be formed to effectuate the proposed transaction. Controlled will use the cash method of accounting.

Distributing has been engaged in Business Y since Year 1. Distributing has provided financial information that indicates that Distributing has had gross receipts and operating expenses representative of the active conduct of Business Y for each of the past 5 years.

Due to disagreements between A and D over the basic policies of management and business practices of Business Y and as a result of a contingent settlement agreement reached in a lawsuit between A and D, it is proposed to divide Distributing's business assets and liabilities so that A and D (as sole income beneficiary of C) may go their separate ways. Accordingly, the following transaction has been proposed:

- (i) Distributing will transfer to Controlled a portion of its assets in exchange for shares of Controlled stock and Controlled's assumption of a portion of Distributing's liabilities.

PLR-134322-02

- (ii) Distributing will then distribute all _____ shares of Controlled stock to C in exchange for all of its z shares of Distributing stock.

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

- (a) The fair market value of the stock of Controlled received by C will be approximately equal to the fair market value of the Distributing stock to be surrendered by C 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) 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 statement submitted.
- (d) Following the transaction, Distributing and Controlled each will continue, independently and with its separate employees, the active conduct of its share of all of the integrated activities of the business conducted by Distributing prior to the consummation of the transaction, except that B will serve in a ministerial capacity for both corporations.
- (e) The distribution of the stock of Controlled is being carried out for the following corporate business purpose: to resolve shareholder disputes and different management plans, and to comply with a settlement agreement resulting from a lawsuit between A and D. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) Distributing is not an S corporation (within the meaning of §1361(a) of the Internal Revenue Code) and there is no plan or intention by Distributing or Controlled to make an S election pursuant to §1362(a).
- (g) 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 either Distributing or Controlled after the 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.

PLR-134322-02

- (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 transaction, except in the ordinary course of business.
- (j) 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 (as determined under §357(d)) by Controlled. The liabilities assumed (as determined under §357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.
- (k) No property is being transferred between Distributing and Controlled upon which any investment credit determined under §46 has been or will be claimed.
- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (n) 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.
- (o) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv).
- (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 stock entitled to vote or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.

PLR-134322-02

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 assets in exchange for the stock of Controlled and the assumption of liabilities, followed by the distribution of all of the stock of Controlled to C in exchange for all of the stock of Distributing owned by C will qualify as 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 to Controlled in exchange for the stock of Controlled and the assumption of liabilities (§§361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled upon the receipt of the assets in exchange for the stock of Controlled (§1032).
- (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 before their transfer to Controlled (§362(b)).
- (5) The holding period of the assets transferred to 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 to C in exchange for all of C’s stock in Distributing (§361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) C upon receipt of the Controlled stock in exchange for C’s Distributing stock (§355(a)(1)).
- (8) The basis of the Controlled stock in the hands of C will be the same as the basis of the Distributing stock surrendered by C in exchange therefor (§358(a)(1)).
- (9) The holding period of the Controlled stock received by C will include the holding period of the Distributing stock surrendered in exchange therefor, provided such stock is held as a capital asset on the date of the transaction (§1223(1)).

PLR-134322-02

- (10) As provided in §312(h), following the distribution of the stock of Controlled, 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.

We express no opinion 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 about rulings.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayers 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 a ruling. Verification of the information, representations, and other data may be required as part of the audit process.

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

It is important that a copy of this letter be attached to the Federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to the taxpayer's authorized representative.

Sincerely yours,

Ken Cohen

Ken Cohen
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel (Corporate)