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Department of the Treasury
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Date:

December 19, 2003

Legend

Distributing =

Controlled =

Business X =

Business Y =

b =

c =

d =

e =

f =

x% =

y% =

A =

B =

C =

D =

Dear

This letter responds to your letter, dated August 8, 2003, requesting rulings under I.R.C. §§ 368 and 355. Additional information was received in a letter dated December 18, 2003. The information submitted is summarized below.

Distributing is a corporation engaged in Business X and Business Y. A and B each own y% (c shares) of the stock. C and D each own x% (b shares) of the stock. A and B are brothers. A is the father of C, and B is the father of D.

The taxpayer has supplied financial information that indicates that each of Business X and Business Y had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

A and C, on the one hand, and B and D, on the other hand, have divergent views as to the current operations and future direction of Business X and Business Y. In order to allow each shareholder to devote his undivided attention to the business in which he is more interested and proficient, the parties have devised the following plan:

- 1) Distributing will transfer all of the assets of Business Y to Controlled in exchange for f shares of the Controlled stock and the assumption by Controlled of the associated liabilities (the "Contribution").
- 2) Distributing will distribute d shares of the Controlled stock to B in exchange for all of his Distributing stock.
- 3) Distributing will distribute e shares of the Controlled stock to D in exchange for all of his Distributing stock. The exchanges described in steps (2) and (3) are collectively characterized as the "Exchange."

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

- (a) 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 (as determined under section 357(d)).

- (b) The liabilities assumed by Controlled in the transaction and the liabilities to which the transferred assets are subject (as determined under section 357(d)) were incurred in the ordinary course of business and are associated with the assets being transferred.
- (c) Certain of the assets to be transferred to Controlled may be "Section 46 property," as that phrase is defined in the Internal Revenue Code. The income tax liability for the taxable year in which investment credit property (including any building to which I.R.C. § 47(d) applies) is transferred will be adjusted pursuant to I.R.C. § 50(a)(1) or (a)(2) (or I.R.C. § 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.
- (d) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the Exchange.
- (e) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Exchange.
- (f) Payments made in connection with 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.
- (g) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (h) No part of the consideration to be distributed by Distributing will be received by a shareholder of Distributing as a creditor, employee or in any capacity other than that of a shareholder of Distributing.
- (i) The fair market value of Controlled stock to be received by B and D will be approximately equal to the fair market value of the Distributing stock surrendered by them in the exchange.
- (j) 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.
- (k) Following the Exchange, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its respective businesses.
- (l) The distribution of Controlled is primarily carried out for the following corporate business purpose: to permit each of the shareholders to devote his undivided

attention to the business in which he is more interested and proficient thus enhancing the operation of each business. The Exchange is motivated, in whole or substantial part, by this corporate business purpose.

- (m) There is no plan or intention by the shareholders of Distributing or Controlled to sell, exchange, transfer by gift or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the Exchange.
- (n) B and D will not acquire any Distributing stock after the Exchange. B and D will not be shareholders, employees, officers, or directors of Distributing after the Exchange. A and C will not acquire any Controlled stock after the Exchange. A and C will not be shareholders, employees, officers, or directors of Controlled after the Exchange.
- (o) 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 Exchange, other than possibly upon the retirement, disability or death of a shareholder, for which there are no current plans or expectations.
- (p) 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 Exchange, except in the ordinary course of business.
- (q) The gross assets of Business X (relied on to satisfy the active trade or business requirement of section 335(b)) to be conducted by Distributing immediately after the Exchange will have a fair market value that is greater than five percent of the total fair market value of Distributing's gross assets at that time.
- (r) The gross assets of Business Y (relied on to satisfy the active trade or business requirement of section 335(b)) to be conducted by Controlled immediately after the Exchange will have a fair market value that is greater than five percent of the total fair market value of Controlled's gross assets at that time.
- (s) For purposes of section 355(d), immediately after the Exchange, no person or persons (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Exchange.
- (t) For purposes of section 355(d), immediately after the Exchange, no person or persons (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled

stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled stock that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Exchange or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Exchange.

- (u) The Exchange 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 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.
- (v) Distributing is not an S corporation (within the meaning of section 1361(a)), and there is no plan or intention by Distributing or Controlled to make an S corporation election, pursuant to section 1362(a), after the Exchange.

Based solely on the information submitted and the representations made, we have concluded that:

- 1 The Contribution, followed by the Exchange, will constitute a reorganization within the meaning of section 368(a)(1)(D) of the Internal Revenue Code. 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 its receipt of f shares of the Controlled stock in exchange for the transfer of assets to, and the assumption of liabilities by, Controlled. Section 361(a) and (b)(1) and section 357(a).
- 3 No gain or loss will be recognized by Controlled upon its receipt of assets in exchange for its issuance of f shares of the Controlled stock. Section 1032(a).
- 4 Controlled's basis in the assets received from Distributing will equal the basis of such assets in the hands of Distributing immediately prior to the transfer. Section 362(b).
- 5 The holding period of each asset received by Controlled from Distributing will include the period during which Distributing held such asset. Section 1223(2).
- 6 Distributing will not recognize gain or loss on the Exchange. Section 361(c)(1).
- 7 No gain or loss will be recognized by (and no amounts will be included in the income of) B and D on the Exchange. Section 355(a)(1).

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- 8 The basis of the Controlled stock in the hands of B and D will, in each case, be the same as the basis of the Distributing stock surrendered in exchange therefor. Section 358(a)(1).
- 9 The holding period of the Controlled stock received by B and D will, in each case, 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 day of the Exchange. Section 1223(1).
- 10 Distributing and Controlled must properly allocate earnings and profits in accordance with section 312(h) and Treas. Reg. § 1.312-10(a).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

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

A copy of this letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Mary E. Goode
Senior Counsel
Branch 6
Office of Associate Chief Counsel
(Corporate)