

Internal Revenue Service

Department of the Treasury

Number: **200318047**
Release Date: 5/2/2003
Index Number: 355.01-01
368.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:2-PLR-147257-02

Date:

January 23, 2003

LEGEND

Distributing =

Controlled =

State X =

Date 1 =

Date 2 =

Business A =

Business B =

Business C =

Business D =

Subsidiary A =

Family Group 1 =

Family Group 2 =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

A =

B =

C =

D =

E =

This letter responds to your August 19, 2002 letter requesting rulings on certain federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated October 23, 2002, December 5, 2002, January 10, 2003, and January 22, 2003. The information submitted in such request and subsequent correspondence is summarized below.

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

Summary of Facts

Distributing was incorporated in State X on Date 1, files its federal income tax return on a fiscal year basis and uses the accrual method of accounting. Distributing is the common parent of an affiliated group of corporations, of which Controlled and Subsidiary A are members. Distributing is engaged directly in Business A.

Controlled is a wholly-owned subsidiary of Distributing, incorporated on Date 2. Controlled files a consolidated federal income tax return with Distributing and uses the accrual method of accounting. Controlled is engaged directly in Business B, Business C, and Business D.

Distributing has outstanding A shares of voting common stock, which are owned by two family groups. Family Group 1 consists of Shareholder 1 (B shares), Shareholder 2 (C shares), and Shareholder 3 (C shares). Family Group 2 consists of Shareholder 4 (B shares), and Shareholder 5 (D shares).

Financial information has been submitted which indicates that Distributing and Controlled each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

The Proposed Transaction

A series of disputes have arisen between Family Group 1 and Family Group 2 regarding a number of fundamental business matters affecting the operations of Business A, Business B, Business C, and Business D (collectively the "Businesses"). The conflicts between the Family Groups are having an adverse effect on the daily operations of the Businesses. To eliminate the damage to the Businesses, the following transaction is proposed (the "Transaction"):

- (i) Distributing will make a cash contribution to Controlled of approximately \$ E to equalize the net fair market value of the assets of Distributing and Controlled (the "Contribution").
- (ii) Distributing will distribute all of the Controlled shares of stock to Shareholder 1, Shareholder 2, and Shareholder 3 in proportion to their existing stock ownership in Distributing (the "Distribution"). Shareholder 1, Shareholder 2, and Shareholder 3 will surrender all of their shares of Distributing stock in exchange for the Controlled shares in the Distribution.

Representations

The taxpayer has made the following representations concerning Distributing, Controlled, and the Transaction:

(a) The fair market value of the stock of Controlled received by Shareholder 1, Shareholder 2, and Shareholder 3 will be approximately equal to the fair market value of the respective Distributing stock surrendered by Shareholder 1, Shareholder 2, and Shareholder 3 in the exchange.

(b) No part of the consideration to be distributed by Distributing will be received by a Distributing shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) The five years of financial information submitted on behalf of Distributing and Controlled represents their present operations, and there have been no substantial operational changes since the date of the last financial statement submitted.

(d) Following the Transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.

(e) The Transaction will be carried out to eliminate shareholder disputes that, if permitted to continue, would jeopardize the operation and continued success of the Businesses. The Transaction is motivated, in whole or substantial part, by this corporate business purpose.

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

(g) 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 § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

(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) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Transaction.

(j) No two parties to the Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(k) 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. Controlled will not assume any liabilities of Distributing in connection with the Contribution, and the assets that Controlled will receive from Distributing in the Contribution will not be subject to any liabilities.

(l) Immediately before the Transaction, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Further, any excess loss account Distributing may have with respect to Controlled stock will be included in income immediately before the Transaction.

(m) Shareholder 1, Shareholder 2, and Shareholder 3 will not acquire any Distributing stock after the Transaction. Shareholder 1, Shareholder 2, and Shareholder 3 will not be shareholders, employees, officers, or directors of Distributing or Subsidiary A after the Transaction. Shareholder 4 and Shareholder 5 will not acquire any Controlled stock after the Transaction. Shareholder 4 and Shareholder 5 will not be shareholders, employees, officers, or directors of Controlled after the Transaction.

(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) Following the Transaction, the gross assets of Business A that Distributing relies on to satisfy the active trade or business requirement of § 355(b) will have a fair market value that is equal to at least 5 percent of the total fair market value of the gross assets of Distributing.

(p) Following the Transaction, the gross assets of Business B, Business C, and Business D that Controlled relies on to satisfy the active trade or business requirement of § 355(b) will have a fair market value that is equal to at least 5 percent of the total fair market value of the gross assets of Controlled.

(q) Distributing is not an S corporation (under § 1361(a)), and neither Distributing nor Controlled expects or plans to make an S corporation election under § 1362(a) after the Transaction.

(r) For purposes of § 355(d), immediately after the Transaction, no person (determined after applying § 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 §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(s) For purposes of § 355(d), immediately after the Transaction, no person (determined after applying § 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 §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(t) The Transaction 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 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.

(u) Distributing and Controlled will allocate earnings and profits in accordance with § 312(h) and Treas. Reg. § 1.312-10(a).

Rulings

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

(1) The Contribution and Distribution will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under § 368(b).

(2) No gain or loss will be recognized by Distributing on the Contribution (§ 361(a)).

(3) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)).

(4) No gain or loss will be recognized by Controlled on the Contribution. (§ 1032(a)).

(5) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Shareholder 1, Shareholder 2, or Shareholder 3 on the receipt of Controlled stock in exchange for their Distributing stock (§ 355(a)(1)).

(6) The aggregate basis of the Controlled stock in the hands of Shareholder 1, Shareholder 2, and Shareholder 3 will, in each instance, equal the aggregate basis of the respective Distributing stock surrendered by the shareholder in the exchange (§ 358(a)(1)).

(7) The basis that Controlled has in each asset received from Distributing will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).

(8) The holding period for each asset received by Controlled in the Contribution will include the period during which Distributing held the asset (§ 1223(2)).

(9) The holding period of the Controlled stock received by Shareholder 1, Shareholder 2, and Shareholder 3 will, in each instance, include the holding period of the respective Distributing stock surrendered by the shareholders, provided such stock is held as a capital asset on the date of the exchange (§ 1223(1)).

Caveats and Procedural Statements

No opinion is expressed about the tax treatment of the Transaction under other provisions of the Code or regulations, or 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 rulings.

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

Each taxpayer involved in this transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the transaction covered by this letter is completed.

Under the power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Mary Goode
Senior Counsel
Office of Chief Counsel (Corporate)
CC:CORP:6