

Internal Revenue Service

Department of the Treasury

Index Numbers: 0355.01-01, 368.04-00

Washington, DC 20224

Number: **200022008**
Release Date: 6/2/2000

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Telephone Number:

Refer Reply To:

CC:DOM:CORP:4 - PLR-117229-99

Date:

February 16, 2000

Distributing =

Controlled =

Business M =

Business N =

A =

Family B =

C =

Family D =

E =

Trust 1 =

Trust 2 =

F Corp =

Partnership =

X =

Y =

Date Z =

We respond to your September 15, 1999 request for rulings regarding certain federal income tax consequences of a proposed transaction.

Summary of Facts

Distributing is an accrual method corporation directly engaged in Business M and Business N. The Distributing common stock is owned x percent by Family B and y percent by Family D.

Distributing was managed primarily by A (the spokesman for Family B) and C (of Family D) until C's death on Date Z. Since then, A and E (now the primary spokesman for Family D) have disagreed over how best to manage Business M and Business N. To resolve these differences, the two families propose to divide the assets of Distributing as follows:

(i) Distributing will transfer to newly formed Controlled all the assets associated with Business N, plus assets needed to equalize the value of Controlled with the value of Family B's interest in Distributing. The additional assets will include stock in F Corp and an interest in Partnership. In exchange, Controlled will issue Controlled stock to Distributing and assume related liabilities (altogether, the "Contribution").

(ii) Distributing will distribute Controlled stock to each of the Family B members in exchange for all of the member's stock in Distributing (collectively, the "Exchanging Shareholders" and the "Distribution").

After the Distribution, Distributing will continue to conduct Business M, and Controlled will continue to conduct Business N.

Representations

The parties have submitted the following representations concerning the proposed transaction:

(a) Distributing, Controlled, and their shareholders each will pay its, his, or her own expenses, if any, incurred in connection with the proposed transaction.

(b) The fair market value of the Controlled stock received by each Exchanging Shareholder will approximately equal the fair market value of the Distributing stock surrendered in the exchange.

(c) No part of the consideration distributed by Distributing will be received by an Exchanging Shareholder as a creditor, employee, or in any capacity other than as a shareholder of Distributing.

(d) The five years of financial information submitted on behalf of Distributing represents 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.

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

(f) The Distribution is motivated, in whole or substantial part, by the corporate business purpose of eliminating disputes between A and E over how best to manage the businesses of Distributing.

(g) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any Distributing or Controlled stock after the transaction, except that Trust 1 and Trust 2 each may distribute part of the stock held by the trust to its beneficiaries, as required by the terms of the trust.

(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, 1996-1 C.B. 696, 705.

(i) There is no plan or intention to liquidate 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 basis and the fair market value of the assets transferred to Controlled by Distributing will equal or exceed the amount of the liabilities assumed (as determined under § 357(d) of the Internal Revenue Code) by Controlled.

(k) 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.

(l) Payments made in any continuing transactions 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.

(m) The investment tax credit previously computed with respect to the section 38 property transferred, if any, will be adjusted in the year of transfer to reflect an early disposition of the property pursuant to § 47(a)(1) and (5) of the Code.

(n) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the distribution of the Controlled stock.

(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) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50 percent or more of the combined voting power of all classes of stock of Distributing or Controlled entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing or Controlled stock, within the meaning of § 355(e).

(q) Distributing is not an S corporation (within the meaning of § 1361(a)) but will elect to be an S corporation (pursuant to § 1362(a)) for its taxable year beginning January 1, 2000. Distributing will be an S corporation on the date of the Distribution. Controlled will elect to be an S corporation on the first available date after the Distribution, and there is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

Rulings

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

(1) The Contribution, followed by the 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) and 357(a)).

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

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

(5) The holding period of each asset received by Controlled will include the holding period of that asset in the hands of Distributing (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Exchanging Shareholders on their receipt of Controlled stock in the Distribution (§ 355(a)(1)).

(8) The basis of the Controlled stock in the hands of each Exchanging Shareholder will equal the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

(9) The holding period of the Controlled stock received by each Exchanging Shareholder will include the holding period of the Distributing stock exchanged therefor, provided the stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) of the Income Tax Regulations.

Caveats

We express no opinion on the federal income tax treatment of the proposed 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 proposed transaction that are not specifically covered by the above rulings.

Procedural Statements

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

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

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer and to a second authorized representative.

Sincerely,
Assistant Chief Counsel (Corporate)
By: Wayne T. Murray
Senior Technician Reviewer
Branch 4