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Department of the Treasury

P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

December 8, 1998

Distributing =

Controlled =

Business X =

Business Y =

a =

b =

State A =

State B =

State C =

This is in response to your authorized representative's letter dated July 31, 1998, requesting rulings under § 355 of the Code with respect to a proposed transaction. Additional

information was received in letters dated October 1, 1998, October 21, 1998, November 20, 1998 and November 27, 1998. The material information submitted is summarized below.

Distributing is a closely-held corporation which files its federal income tax return on a calendar year basis. Distributing is engaged in Business X and Business Y. Financial information has been received indicating that Business X and Business Y have each had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five years. Distributing has one class of stock outstanding. An employee of Distributing holds options on a shares, or approximately b percent, of Distributing stock

Distributing conducts Business X chiefly at two facilities in State A. Distributing conducts Business Y chiefly at a different facility in State A. Recently, Distributing began to expand Business Y by constructing a second facility for Business Y at a fourth location in State A in Year 1. Sales offices for both Business X and Business Y are located both in State A and in State B.

Distributing has also leased warehouse space for its Business Y product in State C. Distributing has submitted information establishing that the leasing of such property in State C will subject Distributing to State C tax on a portion of its income from both Business X and Business Y. Information, documentation, and analysis have been provided demonstrating that a separation of Business X and Business Y into separate corporations will result in significant savings in State C tax. The information indicates that those savings meet the requirements of Appendix A, Sec. 2.04 of Rev. Proc. 96-30, 1996-1 C.B. 696, 710. In order to accomplish that separation, Distributing proposes the following series of transactions:

(1) Distributing will form Controlled, which will have no stock authorized and outstanding other than one class of common stock. Distributing will contribute the assets of Business Y, subject to the assumption of certain liabilities associated with Business Y, to Controlled in exchange for all the Controlled common stock.

(2) Distributing will then distribute pro rata to its shareholders all of the Controlled stock held by Distributing (the "Distribution"). In connection with the Distribution, the outstanding stock option agreement will be amended to entitle the option holder to purchase Controlled stock in addition to Distributing stock in order to maintain the same current economic interest in Distributing's businesses..

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

(a) 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 Distributing.

(b) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operation, and with regard to such corporation, there have been no substantial operational changes, other than the construction of the new Business Y facility mentioned above, since the date of the last financial statements submitted.

(c) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business with the following exceptions: Shareholder A will continue as President of both Distributing and Controlled; Distributing's present Vice President of Finance will be Vice President of Finance for both Distributing and Controlled; and Distributing's Finance and Data Processing areas will continue to serve both Distributing and Controlled. Controlled will reimburse Distributing for work performed by any employee on behalf of Controlled with compensation determined at fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(d) The Distribution is carried out for the following corporate business purpose, among others: cost saving. The Distribution is motivated, in whole or substantial part, by that corporate business purpose.

(e) Distributing is not an S corporation (within the meaning of § 1361(a) and there is no present plan or intention by Distributing or Controlled to make an S corporation election pursuant to § 1362(a).

(f) 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 , or securities of, either Distributing or Controlled.

(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 section 4.05(1)(b) of Rev. Proc. 96-30.

(h) 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.

(i) The liabilities assumed in the 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.

(j) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

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

(l) Payments made in connection with all continuing transactions will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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

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

(1) The transfer by Distributing to Controlled of the assets of Business Y, subject to the assumption of certain liabilities associated with Business Y, in exchange for all of the common stock of Controlled, followed by the distribution of all the Controlled stock to the shareholders of Distributing, will constitute a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled will each be "a party to a reorganization" within the meaning of section 368(b) of the Code.

(2) Distributing will recognize no gain or loss upon the transfer of assets to Controlled in exchange for Controlled stock and the assumption of liabilities, as described above (sections 361(a) and 357(a)).

(3) Controlled will recognize no gain or loss on the receipt of the assets in exchange for all the shares of Controlled (section 1032(a)).

(4) Controlled's basis in the Distributing assets received by Controlled in the transaction will be the same as the basis of such assets in the hands of Distributing immediately prior to the transaction (section 362(b)).

(5) Controlled's holding period of the Distributing assets received by Controlled in the transaction will include the period during which such assets were held by Distributing (section 1223(2)).

(6) The shareholders of Distributing will recognize no gain or loss (and no amount will be included in the income of the shareholders of Distributing) upon the receipt of Controlled stock in exchange for their Distributing stock, as described above (section 355(a)(1)).

(7) The basis of the stock of Distributing and Controlled in the hands of the shareholders of Distributing after the Distribution will be the same as the aggregate basis of the Distributing stock in the hands of those shareholders immediately before the Distribution, allocated between the Distributing stock and the Controlled Stock in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a)(2) (section 358(a)).

(8) The holding period of the Controlled stock to be received by the shareholders of Distributing, as described above, will include the period of the Distributing stock surrendered in

the exchange, provided that such stock is held as a capital asset by those respective shareholders on the day of the exchange (section 1223(1)).

(9) No gain or loss will be recognized to Distributing upon the distribution of all its Controlled stock to Distributing shareholders (section 361(c)).

(10) A proper allocation of earnings and profits between Distributing and Controlled will be made pursuant to section 312(h) of the Code and § 1.312-10(a) of the Income Tax Regulations.

No opinion is expressed as to the tax treatment of the transaction under other provisions 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 by the above ruling.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,
Assistant Chief Counsel (Corporate)

By *Lewis K. Brickates*
Lewis K Brickates
Assistant to the Chief, Branch 2