

Internal Revenue Service

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Person to Contact:

Telephone Number:

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Legend

Distributing =

Controlled #1 =

Controlled #2 =

A =

B =

C =

D =

Trust =

Business X =

Business Y =

Business Z =

Business U =

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Business V =

Sector 1 =

Sector 2 =

a =

Year 1 =

State =

Dear :

This is in response to a letter dated February 20, 2002, submitted on behalf of Distributing, requesting rulings under §§ 355 and 368 of the Internal Revenue Code (the "Code") with respect to a proposed and partially completed transaction. Additional information was received in letters dated June 11, 2002, July 12, 2002, August 13, 2002, and August 29, 2002.

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. The material information submitted is summarized below.

Distributing is a corporation that files federal income tax returns on a calendar-year basis and uses the cash method of accounting. Distributing is engaged chiefly in Business X and Business Y. Prior to Year 1, Distributing was also engaged in Business U and Business Z.

The stock of Distributing is owned by individuals A, B, C, D, Trust (a trust for the benefit of D during D's lifetime and thereafter for individuals A, B, and C and the children of A, B, and C), and members of the immediate families of each of A, B, and C. Disagreements have arisen among A, B, and C about the business. Specifically, while A, B, and C all want to continue in Business X, B wants to phase out Business Y and to reenter Business U and Business Z (specifically in Sector 1 of Business Z). C wants to continue Business Y, reenter Business Z (but in Sector 2 of Business Z), and begin Business V. A wants to phase out Business Y. The following series of transactions is therefore proposed:

Distributing has formed two corporations, Controlled #1 and Controlled #2 (collectively, the "Controlled Corporations"). Distributing has contributed to Controlled #1 assets now used or suitable for Business X, Business Y, and Business U.

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Distributing has contributed to Controlled #2 assets now used or suitable for Business X and Business Y. Distributing has kept assets now used or suitable for Business X, Business Y, Business Z, and Business V.

Distributing will distribute all of the stock of Controlled #1 to B and to the members of the B family holding Distributing stock, in exchange for all the shares of Distributing held by such shareholders, and to D and Trust, in exchange for Distributing shares. Distributing will distribute all of the stock of Controlled #2 to A and to the members of the A family holding Distributing stock, in exchange for all the shares of Distributing held by such shareholders, and to D and Trust, in exchange for Distributing shares. The transactions just described are sometimes referred to hereinafter as the Distribution.

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 past five years.

Distributing has made the following representations with respect to the Distribution:

- (a) The fair market value of the stock of each of the Controlled Corporations to be received by each shareholder of Distributing will be approximately equal to the fair market value of the stock of Distributing surrendered in the exchange.
- (b) 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.
- (c) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operation, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the Distribution, Distributing and each of the Controlled Corporations 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.
- (e) The Distribution is being carried out for the following corporate business purpose: to resolve disagreements among the shareholders as to the expansion and diversification of Distributing's businesses. The distribution of the stock, or stock and securities, of each of the Controlled

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Corporations is motivated in whole or substantial part, by this business purpose.

- (f) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing, Controlled #1, or Controlled #2 after the transaction, except for gifts by shareholders of Distributing or the Controlled Corporations to the immediate family of such shareholders.
- (g) There is no plan or intention by either Distributing, Controlled #1, or Controlled #2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distribution, other than through purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (h) There is no plan or intention to liquidate either Distributing, Controlled #1, or Controlled #2, to merge either Distributing, Controlled #1, or Controlled #2 with any other corporation, or to sell or otherwise dispose of the assets of Distributing, Controlled #1, or Controlled #2 after the Distribution, except in the ordinary course of business.
- (i) The Distribution is not part of a plan or series of related transactions (within the meaning of Code § 355(e)) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50% or more of the total combined voting power of all classes of stock of either Distributing or any of the Controlled Corporations entitled to vote or stock possessing 50% or more of the total value of all classes of stock of either Distributing or any of the Controlled Corporations.
- (j) The total adjusted basis and the fair market value of the assets transferred to each of the Controlled Corporations by Distributing each equals or exceeds the sum of the liabilities assumed by each of the Controlled Corporations plus any liabilities to which the transferred assets are subject. 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.
- (k) The income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by P.L. 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Distribution.

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- (m) No intercorporate debt will exist between Distributing and either of the Controlled Corporations at the time of, or subsequent to, the Distribution.
- (n) Payments made in connection with all continuing transactions, if any, between Distributing and either of the Controlled Corporations 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 Distribution are investment companies as defined in Code § 368(a)(2)(F)(iii) and (iv).
- (p) As soon as is practicable, a petition will be filed in State court to modify the Trust to provide that: (i) Distributions of any shares in Controlled #2 will not be made to or Shareholder B or Shareholder C or members of the immediate families of Shareholder B and Shareholder C; ii) Distributions of any shares in Controlled #1 will not be made to or Shareholder A or Shareholder C or members of the immediate families of Shareholder A and Shareholder C; iii) Distributions of any shares in Distributing will not be made to or Shareholder B or Shareholder A or members of the immediate families of Shareholder B and Shareholder A. The current income and remainder beneficiaries of Trust have consented to that modification of Trust.
- (q) As soon as practicable, Shareholder D will modify Shareholder D's will in order to assure separation of interests in the Distributing, Controlled #1, and Controlled #2 by providing that: (i) Distributions of any shares in Controlled #2 will not be made to or Shareholder B or Shareholder C or members of the immediate families of Shareholder B and Shareholder C; ii) Distributions of any shares in Controlled #1 will not be made to or Shareholder A or Shareholder C or members of the immediate families of Shareholder A and Shareholder C; iii) Distributions of any shares in Distributing will not be made to or Shareholder B or Shareholder A or members of the immediate families of Shareholder B and Shareholder A.

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

- (1) The transfer by Distributing to each of the Controlled Corporations of property in exchange for all of the stock of each of the Controlled Corporations, as described above, will in each case constitute a reorganization within the meaning of Code § 368(a)(1)(D). Distributing and each of the Controlled Corporations will each be a party to a reorganization within the meaning of Code § 368(b).

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- (2) Distributing will not recognize any gain or loss upon the transfer of its assets to the Controlled Corporations in exchange for shares of 100% of the common stock of the Controlled Corporations and the assumption of certain liabilities by the Controlled Corporations. Code §§ 361(a) and 357(a).
- (3) No gain or loss will be recognized to the Controlled Corporations upon the receipt of Distributing's assets in exchange for 100% of the stock of the Controlled Corporations and the assumption of the liabilities of Distributing by the Controlled Corporations. Code § 1032(a).
- (4) The basis of the assets received by the Controlled Corporations from Distributing will be the same as the basis of such assets in the hands of Distributing immediately prior to the transfer. Code § 362(b).
- (5) The holding period of each asset received by the Controlled Corporations from Distributing will include the period during which Distributing held such asset. Code § 1223(2).
- (6) No gain or loss will be recognized to Distributing upon the distribution to the Shareholders of 100% of the shares of the common stock of the Controlled Corporations pursuant to the Distribution. Code § 361(c)(1).
- (7) No gain or loss will be recognized to, and no amount will be included in the income of, the Shareholders upon the exchange of their shares of Distributing common stock for shares of the common stock of the Controlled Corporations pursuant to the Distribution. Code § 355(a)(1).
- (8) The basis of the shares of the common stock of each of the Controlled Corporations will be the same as the basis of the Distributing common stock surrendered in exchange therefor. Code § 358(a)(1).
- (9) The holding period of the shares of the stock of the each of the Controlled Corporations to be received by the Shareholders will include the period during which the Shareholders held the Distributing stock surrendered in exchange therefor, provided that such shareholder held the Distributing stock as a capital asset on the date of the Distribution. Code § 1223(1).
- (10) As provided in Code § 312(h), the earnings and profits of Distributing will be allocated among the Controlled Corporations under Treas. Reg. § 1.312-10(a).

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No opinion is expressed as to the tax treatment of the transactions 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 transactions that are not specifically covered by the above ruling.

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

Sincerely yours, _____

Marlene P. Oppenheim

Marlene P. Oppenheim
Senior Counsel, Branch 2
Office of Associate Chief Counsel (Corporate)