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Department of the Treasury  
Washington, DC 20224

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Person To Contact:

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Telephone Number:

Refer Reply To:

CC:CORP:BO6 – PLR-123190-03

Date:

September 30, 2003

LEGEND

Distributing	=
Controlled 1	=
Controlled 2	=
Business A	=
Business B	=
Business C	=
Business D	=
Corporation 1	=
Corporation 2	=
Corporation 3	=
Corporation 4	=
Corporation 5	=
Corporation 6	=
Name	=
Shareholder 1	=
Shareholder 2	=
Shareholder 3	=
Shareholder 4	=
Shareholder 5	=
Shareholder 6	=
Shareholder 7	=
Shareholder 8	=
Shareholder 9	=
Shareholder 10	=
Shareholder 11	=
Date 1	=
Date 2	=

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Date 3 =  
 State =  
 a =  
 b =  
 c =  
 d =  
 e =  
 f =  
 g =  
 h =  
 i =  
 j =  
 l =  
 k =  
 m =

Dear :

This letter is in response to your authorized representative's letter dated April 1, 2003, requesting rulings on certain federal income tax consequences of a proposed transaction. Additional information was received in letters dated June 20, 2003, July 15, 2003, August 26, 2003, and September 15, 2003. The information submitted is summarized below.

The rulings contained in this letter are based on 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 the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

**Summary of Facts**

Prior to the Date 1 incorporation of Distributing in State, each member of the Name family, including a trust, directly owned all the outstanding shares of Corporation 1 and most of the outstanding shares of Corporation 4. Also, two members of the Name family (referred to as "Shareholders 2 and 7" herein) each directly owned a limited number of shares of Corporations 3 and 5. Corporations 2 and 3 were subsidiaries of Corporation 1. Corporation 6 was a subsidiary of Corporation 5, which was a subsidiary of Corporation 4.

Distributing was formed by the members of the Name family. Each family member, as well as the trust, contributed all the stock he or she directly owned in

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Corporations 1, 3, 4 and 5 to Distributing in exchange for either or both of Distributing's voting Class A common and voting Class B common stock. In return, Shareholders 1 to 6 received voting Class A common (Shareholder 3 is an irrevocable trust for the benefit of Shareholders 4, 5 and 6). Shareholders 1 and 7 to 11 received voting Class B common stock (Shareholder 7 originally was an individual. Shareholder 7 is now an estate whose principal beneficiary is a trust for the benefit of Shareholders 8, 9 and 10).

The right to elect 2 members of Distributing's 4-member board of directors is accorded to each class of Distributing stock. The classes of stock differ only in that each was initially entitled to receive different assets upon liquidation of Distributing: The holders of the Class A common stock were entitled to receive all the stock of Corporation 1 and the holders of the Class B common stock were entitled to receive all the stock of Corporation 4. To date, Distributing has not liquidated.

Distributing is a holding corporation and, prior to Corporation 1's liquidation, was not directly engaged in any business activity. After its Date 2 capitalization, Distributing directly owned all the outstanding stock of Corporations 1 and 4, and indirectly owned all or substantially all the stock of Corporations 2, 3, 5 and 6. Corporation 1 liquidated on Date 3. As a result of Corporation 1's liquidation, Distributing became directly engaged in Business A.

Corporation 1 was and Corporations 2, 3 and 6 are operating corporations. Corporation 1 was directly engaged in Business A and had been so engaged at all times during the 5 years period preceding its liquidation. Corporation 2 is now and has been for over 5 years directly engaged in Business B. Corporation 3 is now and has been for over 5 years directly engaged in Business C. Corporation 6 is and has been for over 5 years directly engaged in Business D. Corporations 4 and 5 are holding companies.

Distributing's outstanding stock consists only of voting Class A common and voting Class B common. The Voting Class A Common stock is held by the following shareholders in the following percentages: Shareholder 1 (a%), Shareholder 2 (b%); Shareholder 3 (c%), Shareholder 4 (d%); Shareholder 5 (e%) and Shareholder 6 (f%). The following shareholders hold voting Class B common stock in the following percentages: Shareholder 1 (g%), Shareholder 7 (h%), Shareholder 8 (i%), Shareholder 9 (j%), Shareholder 10 (k%), and Shareholder 11 (l%).

Financial information has been received indicating that Business A, Business C, and Business D each had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years. (Although

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Business B has been in existence for over 5 years, Distributing is not relying on Business B for qualification under Code § 355).

The various shareholders of Distributing have divergent views as to the current operations and future directions of Businesses A, B, C and D, which have adversely affected the business operations of Distributing. Further, each shareholder wishes to concentrate on the business in which he or she has an interest. Shareholders 1, 7, 9, 10 and 11 are interested in Business D. Shareholders 1, 2, 3, 4, 5 and 6 are interested in Business B and Business C. Shareholders 8 and 10 are interested in Business A. In order to address the problem created by their divergent views and to allow various groups of shareholders to focus on certain businesses to the exclusion of other businesses, the following series of transactions is proposed:

### **Proposed Transaction**

1. Immediately prior to the proposed distributions, Corporations 2 and 3 will be converted into limited liability companies and both companies will elect to be disregarded entities under Treas. Reg. § 301.7701-3(b)(1)(ii). As a result of these conversions, Corporations 2 and 3 will be treated as divisions of Distributing.

2. Immediately prior to the proposed distributions, Corporation 5 will be liquidated into Corporation 4. Immediately thereafter, Corporation 4 will redeem its minority shareholders and liquidate into Distributing. As a result of these two liquidations, Corporation 6 will become a first-tier subsidiary of Distributing.

3. Immediately prior to the proposed distributions, Distributing will form Controlled 1 and will contribute to it Corporation 2 stock, Corporation 3 stock and cash. Distributing will receive in exchange for these contributions all of the common stock of Controlled 1.

4. Immediately prior to the proposed distributions, Distributing will form Controlled 2 and contribute to it Business A and any liabilities associated with Business A. Distributing will receive in exchange for this contribution all of the common stock of Controlled 2. Corporation 6 will remain a first tier subsidiary of Distributing, both immediately before and after the proposed distributions.

5. Distributing will redeem all of its outstanding voting Class A common stock from Shareholders 1, 2, 3, 4, 5 and 6. Following the redemption, Distributing will distribute to them all of the outstanding common stock of Controlled 1.

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6. Distributing will redeem all voting Class B common stock held by Shareholders 8 and 10 from those shareholders. Following the redemption, Distributing will distribute to them all of the outstanding common stock of Controlled 2.

After the Distribution, Shareholders 1, 2, 3, 4, 5 and 6 will own Controlled 1 and will thereafter be engaged in Business B and Business C. Shareholders 1, 7, 9, 10 and 11 will own Distributing (which holds the stock of Corporation 6) and will thereby be indirectly engaged in Business D. Shareholders 8 and 10 will own Controlled 2 and will thereby be engaged in Business A.

Shareholder 1 will have an interest in Controlled 1 and will retain a small interest in Distributing. Shareholder 10 will have an interest in Controlled 2 and will retain a small interest in Distributing. Neither Shareholder 1 nor Shareholder 10 will hold more than a small percentage of Distributing stock and so neither shareholder will have either individually or collectively significant control over Distributing.

### **Representations**

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

1. The fair market value of the Controlled corporations' stock and other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of Distributing stock surrendered by the shareholder in the exchange.
2. 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 the corporation.
3. The five years of financial information submitted on behalf of Distributing and Corporation 6 is representative of each corporation's present operation and, with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted, other than with respect to the liquidation of Corporation 1 on Date 3.
4. The five years of financial information submitted on behalf of Corporation 2 and Corporation 3 is representative of each corporation's present operation and, with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

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5. The five years of financial information submitted on behalf of Corporation 1 and Business A is representative of the corporation's present operation and, with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted, other than with respect to the liquidation of Corporation 1.

6. Immediately after the distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock and securities of the controlled corporation, Corporation 6, that is engaged in the active conduct of a trade or business as defined in I.R.C. § 355(b)(2).

7. Immediately after the Distribution, the gross assets of Corporation 6's Business D will have a fair market value of at least 5 percent of the total fair market value of the gross assets of Corporation 6.

8. Immediately after the Distribution, the gross assets of Controlled 1's Business C will have a fair market value that is at least 5 percent of the total fair market value of the gross assets of Controlled 1.

9. Immediately after the Distribution, the gross assets of Controlled 2's Business A will have a fair market value of at least five percent (5%) of the total fair market value of the gross assets of Controlled 2.

10. Following the Distribution, Distributing, Controlled 1 and Controlled 2 will each continue the active conduct of its business, independently and with its separate employees.

11. The distribution of stock, or stock and securities, of Controlled 1 and Controlled 2 is carried out for the following corporate business purposes: management disagreements and shareholder disputes which have an unfavorable effect on the operations of Distributing. The distribution of stock, or stock and securities, of Controlled 1 and Controlled 2 is motivated, in whole or substantial part, by one or more of these corporate business purposes.

12. 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 of their stock in, or securities of, either Distributing, Controlled 1 or Controlled 2 after the Distribution.

13. 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 stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

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14. There is no plan or intention to liquidate either Distributing Controlled 1, or Controlled 2, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Distribution, except in the ordinary course of business.

15. The Distribution is not part of a plan or a series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing fifty percent or more of the total combined voting power of all classes of either Distributing, Controlled 1 or Controlled 2 stock entitled to vote or stock possessing 50 percent or more of the total value of shares of all classes of stock of either Distributing, Controlled 1 or Controlled 2.

16. For purposes of I.R.C. § 355(d), immediately after the distribution, no person (determined after applying I.R.C. § 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 I.R.C. §§ 355(d)(5) and (8)) during the five-year period (determined after applying I.R.C. § 355(d)(6)) ending on the distribution date.

17. For purposes of I.R.C. § 355(d), immediately after the distribution, no person (determined after applying I.R.C. § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled 1 or Controlled 2 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled 1 or Controlled 2 stock, that was either (i) acquired by purchase (as defined in I.R.C. §§ 355(d)(5) and (8)) during the five-year period (determined after applying I.R.C. § 355(d)(6)) ending on the distribution date, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in I.R.C. §§ 355(d)(5) and (8)) during the five-year period (determined after applying I.R.C. § 355(d)(6)) ending on the distribution date.

18. The total adjusted bases and the fair market value of the assets transferred to Controlled 1 by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled 1 plus any liabilities to which the transferred assets are subject.

19. The liabilities assumed by Controlled 1 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.

20. The total fair market value of the assets transferred to Controlled 2 by Distributing equals or exceeds the sum of the liabilities assumed by Controlled 2 plus any liabilities to which the transferred assets are subject. The liabilities assumed, plus

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any liabilities to which the transferred assets are subject, are in excess of the adjusted basis of the assets transferred to Controlled 2 by Distributing.

21. The liabilities assumed by Controlled 2 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.

22. Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Distribution.

23. No intercorporate debt will exist between Distributing and Controlled 1 or Distributing and Controlled 2 at the time of, or subsequent to, the distribution of the Controlled 1 and Controlled 2 stock.

24. Immediately before the distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Further, Distributing's excess loss account, if any, with respect to the Controlled 1 and Controlled 2 stock will be included in income immediately before the distribution.

25. Payments made in connection with all continuing transactions, if any, between Distributing, Controlled 1, and Controlled 2, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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

27. Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing, Controlled 1 or Controlled 2 to make an S corporation election pursuant to § 1362(a).

28. The Class A stock and Class B stock issued by Distributing on Date 2 is stock of Distributing, and is not, and was not, stock in either Corporation 1 or Corporation 4.

29. Distributing was in control of Corporation 1 and Corporation 4 at the time the Class A stock and Class B stock were issued.

30. Distributing will have control of Controlled 1 and Controlled 2 immediately prior to the proposed distributions.

31. At the time Distributing was formed, there was no plan or intention on the part of any of the shareholders of Distributing or of Distributing, Corporation 1 or

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Corporation 4 that Distributing would be liquidated within five (5) years of its formation or at anytime thereafter.

### **Rulings**

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

1. The contributions of assets by Distributing to Controlled 1 followed by the distribution of Controlled 1 stock will qualify as a reorganization within the meaning of I.R.C. § 368(a)(1)(D).

2. The contribution of assets by Distributing to Controlled 2 followed by the distribution of Controlled 2 stock will qualify as a reorganization within the meaning of I.R.C. § 368(a)(1)(D).

3. Distributing, Controlled 1 and Controlled 2 will each be a “party to a reorganization” within the meaning of I.R.C. § 368(b).

4. No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled 1 in exchange for stock of Controlled 1. I.R.C. § 361(a). No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled 2 in exchange for stock of Controlled 2, except for liabilities in excess of basis. I.R.C. § 361(a); I.R.C. § 357(c).

4. No gain or loss will be recognized by Controlled 1 upon the receipt of Distributing assets in exchange for the stock of Controlled 1. I.R.C. § 1032(a). No gain or loss will be recognized by Controlled 2 upon the receipt of Distributing assets in exchange for the stock of Controlled 2. I.R.C. § 1032(a).

6. The basis of Controlled 1 common stock that is received by Distributing in the exchange will be the same as the basis of the property transferred in exchange therefor, reduced by the sum of the liabilities assumed by Controlled 1 or to which assets transferred are taken subject. I.R.C. § 358(a).

7. The basis of Controlled 2 common stock that is received by Distributing in the exchange will be the same as the basis of the property transferred in exchange therefor, reduced by the sum of the liabilities assumed by Controlled 2 or to which assets transferred are taken subject. I.R.C. § 358(a).

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8. The basis of the property received by Controlled 1 will be the same as the basis of such property in the hands of Distributing immediately prior to the exchange. I.R.C. § 362(a).

9. The basis of the property received by Controlled 2 will be the same as the basis of such property in the hands of Distributing immediately prior to the exchange, increased by the amount of gain recognized by Distributing on the transfer. I.R.C. § 362(a).

10. Distributing's holding period in the common stock of Controlled 1 that is received in the transaction will include the period during which the property exchanged was held by Distributing, provided that such property was a capital asset or property described in § 1231 of the Code on the date of the exchange.

11. Distributing's holding period in the common stock of Controlled 2 that is received in the transaction will include the period during which the property exchanged was held by Distributing, provided that such property was a capital asset or property described in § 1231 of the Code on the date of the exchange.

12. Controlled 1's holding period in the assets received from Distributing will include the period during which the property exchanged was held by Distributing. I.R.C. § 1223(2).

13. Controlled 2's holding period in the assets received from Distributing will include the period during which the property exchanged was held by Distributing. I.R.C. § 1223(2).

14. No gain or loss will be recognized by Distributing on the distribution. I.R.C. § 355(c).

15. No gain or loss will be recognized by (and no amount will otherwise be included in the income of) any shareholder on receipt of Controlled 1 stock from Distributing in the distribution. I.R.C. § 355(a)(1).

16. No gain or loss will be recognized by (and no amount will otherwise be included in the income of) any shareholder on receipt of Controlled 2 stock from Distributing in the distribution. I.R.C. § 355(a)(1).

17. The basis of the Controlled 1 stock received by each shareholder will equal the basis of the Distributing stock surrendered in the distribution. I.R.C. § 358(a)(1).

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18. The basis of the Controlled 2 stock received by each shareholder will equal the basis of the Distributing stock surrendered in the distribution. I.R.C. § 358(a)(1).

19. The holding period of the Controlled 1 stock received by each shareholder will include the period during which the shareholder held the Distributing stock surrendered in the exchange therefore, provided the Distributing stock was held as a capital asset on the date of the distribution. I.R.C. § 1223(1).

20. The holding period of the Controlled 2 stock received by each shareholder will include the period during which the shareholder held the Distributing stock surrendered in the exchange therefore, provided the Distributing stock was held as a capital asset on the date of the distribution. I.R.C. § 1223(1).

21. As provided in I.R.C. § 312(h), proper allocation of earnings and profits between Distribution and Controlled 1 will be made under Treas. Reg. § 1.312-10(b).

22. As provided in I.R.C. § 312(h), proper allocation of earnings and profits between Distribution and Controlled 2 will be made under Treas. Reg. § 1.312-10(b).

### **Caveats**

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. In particular, no opinion is expressed or implied as to the legal correctness of Taxpayer's representations that: (1) the Class A stock and Class B stock issued by Distributing on Date 2 was stock of Distributing, rather than of Corporation 1 and Corporation 4; and (2) Distributing will have control of Controlled 1 and Controlled 2 immediately prior to the proposed distributions. Moreover, no opinion is expressed or implied as to whether the liquidation of Corporations 1, 5 and 6 and the deemed liquidations pursuant to the elections by Corporations 2 and 3 to be classified as disregarded entities under Treas. Reg. § 301.7701-3 qualify as tax-free liquidations under Code §§ 332 and 337.

### **Procedural Statements**

This ruling is directed only to the taxpayer(s) requesting it. § 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.

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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,

*Steven J. Hankin*

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Senior Technician Reviewer, Branch 6  
Office of Associate Chief Counsel  
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