

Internal Revenue Service

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Department of the Treasury

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Person to Contact:

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**CC:DOM:CORP:2 - PLR-115567-98
Date: June 1, 1999**

In re:

LEGEND:

Distributing =

Trust =

Settlor =

Child 1 =

Child 2 =

Child 3 =

Child 4 =

Child 5 =

Child 6 =

State A =

Date 1 =

Date 2 =

Date 3 =
Date 4 =
Business W =

X =
Y =
Z =
Business B =

Dear :

This is in reply to your letter requesting rulings about the transaction described in this letter. The information submitted for consideration is substantially as set forth below.

Distributing was incorporated in State A on Date 1. It is a calendar year, cash basis taxpayer engaged in Business W. Distributing has authorized X shares of non-voting common stock class A and Y shares of Class B common stock with voting rights. No shares of Class A stock are outstanding and Z shares of Class B stock are outstanding. All of the outstanding Class B stock is owned by Trust.

Trust is a cash basis, calendar year taxpayer and is a complex trust. It was created on Date 2 by Settlor who died on Date 3. The primary purpose for its creation was the ownership and management of Distributing. Settlor's six children (The Children) were the primary beneficiaries of the Trust. In the Declaration of Trust, the Settlor provided that the trust would terminate upon the sale of all of the stock in Distributing or upon the liquidation of Distributing at which time the Trust property would be distributed to Settlor's then living issue by right of representation. It has been represented that if the Trust were terminated, the Settlor's children would be the sole takers of the trust assets.

Bitter disputes have developed among the Children regarding the business and operation of Distributing. The Children have divided into two groups: the Midwest Group which is comprised of Child 1, Child 5, and Child 6 and the East Coast Group which is comprised of Child 2, Child 3, and Child 4. These disputes have resulted in two lawsuits. The first involved breach of fiduciary duty. The second resulted in a court ruling appointing a receiver for Distributing on Date 4. The lawsuits have curtailed Distributing's Business B and have caused it to incur expenses for legal fees and receiver fees.

In a mediation session against the possibility of a court ordered liquidation of Distributing, the parties to the litigation developed a plan which would partition Distributing into two separate but equal corporations which would be distributed to the Trust followed by the distribution of the stock of the corporations to each of the two groups. This plan was approved by the court which ordered the termination of the trust after completion of the distribution. The following transaction is proposed:

- (i) Distributing will create Controlled and transfer to it assets having one-half of the equity of Distributing
- (ii) Distributing will transfer all of its stock in Controlled to Trust
- (iii) Trust will terminate and all of the assets of Trust including the stock of Distributing and Controlled will be distributed to the Children
- (iv) The stock of one of the corporations (Distributing or Controlled) will be distributed in equal shares to the members of the East Coast Group and the shares of the other corporation will be distributed in equal shares to the members of the Midwest Group. It is the intention of the parties to flip a coin immediately prior to the termination of Trust to determine which group will receive stock of Distributing and which group will receive stock of Controlled.

In connection with the proposed transaction, Distributing has made the following representations:

- (a) The indebtedness owed by the controlled corporation to the distributing corporation after the distribution of the controlled corporation stock will not constitute stock or securities.
- (b) The five years of financial information submitted on behalf of the distributing corporation 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.
- (c) Following the transaction, the distributing and controlled corporations will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the businesses conducted by the distributing corporation prior to consummation of the transaction.

- (d) The distribution of the stock of Controlled is carried out to facilitate the division of the two shareholder groups and thereby eliminate the negative impact on Distributing's business that has resulted from the disputes between them. The distribution of the stock, or stock and securities, of Controlled is motivated in whole or substantial part by one or more of these corporate business purposes.
- (e) There is no plan or intention by any of the Children to sell, exchange, transfer by gift or otherwise dispose of any stock in, either the distributing corporation or the controlled corporation after the transaction.
- (f) 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.
- (g) There is no plan or intention to liquidate either the distributing corporation or the controlled corporation, 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.
- (h) The total adjusted basis 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; and 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.
- (i) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled.
- (k) 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.
- (l) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (m) Distributing and Trust have represented that there is no distribution in

satisfaction of a right to receive any specific dollar amount or specific property.

- (n) Trust does not intend to make the election to recognize gain or loss under section 643(e).

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

- (1) The transfer by Distributing to Controlled of assets subject to certain liabilities and Controlled's assumption of other liabilities, solely in exchange for all of the outstanding stock of Controlled followed by the distribution of all of the stock of Controlled to Trust will be 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).
- (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. Sections 361(a) and 357(a).
- (3) Controlled will recognize no gain or loss on the receipt of the assets of Distributing in exchange for all of the shares of Controlled. Section 1032(a).
- (4) Controlled's basis in the assets it receives from Distributing will be the same as the basis of such assets in the hands of Distributing immediately prior to the proposed transaction. Section 362(b).
- (5) Controlled's holding period for the assets received from Distributing will include the period during which such assets were held by Distributing. Section 1223(2).
- (6) Distributing will recognize no gain or loss upon the distribution of all its Controlled stock to Trust. Section 361(c).
- (7) Trust will recognize no gain or loss upon the receipt of Controlled stock in the proposed transaction. Section 355(a)(1).
- (8) Trust's basis in the stock of Distributing and Controlled immediately after the proposed transaction will be the same as Trust's basis in the Distributing stock immediately before the proposed transaction, allocated between Distributing and Controlled in proportion to their fair market values. Section 358(a) and (b) and Treas. Reg. Section 1.358-2(a)(2).

- (9) Trust's holding period in the stock of Controlled immediately after the proposed transaction will include the holding period of the Distributing stock with respect to which the distribution was made provided that the Distributing stock was held as a capital asset by Trust on the date of the distribution. Section 1223(1).
- (10) As provided in Section 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with Section 1.312-10(a) of the Regulations.
- (11) No gain or loss will be realized by Trust or its beneficiaries by reason of the proposed distributions of the stock of Distributing and Controlled. Treas. Reg. 1.661(a)-2(f)(1).
- (12) The Children will not realize gain or loss under section 1001 as a result of the proposed transaction.
- (13) If Trust does not make an election pursuant to section 643(e)(3), the adjusted basis of the distributed property in the hands of the Children will be the basis of such property in the hands of Trust immediately before the distributions. Section 643(e)(1).
- (14) The holding period of the distributed property in the hands of the Children will include the holding period of the Trust with respect to such property. Section 1223(2).

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about 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.

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

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling is consummated.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By: _____
Richard L. Osborne
Senior Technician Reviewer, Branch 2