Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index Number: 0355.00-00
0368.04-00

Number: **199952032**
Release Date: 12/30/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP:1 - PLR-106932-99

Date:
September 27, 1999

Re:

Distributing : =

Controlled: =

Subsidiary: =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

State A	=	
Date A	=	
Business A	=	
Business B	=	
a	=	
b	=	
c	=	
d	=	
e	=	
f	=	
g	=	
h	=	
i	=	
j	=	
k	=	
l	=	
m	=	
n	=	
o	=	

Dear :

This letter is in reply to your letter dated March 23, 1999, requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated June 25, July 27, September 7, and September 21, 1999. The information submitted for consideration is summarized below.

Distributing is an accrual basis State A corporation and the common parent of a affiliated group of corporations filing a consolidated federal income tax return. Distributing is indirectly engaged through its subsidiaries in various businesses including Business A and Business B. Distributing has outstanding a shares of voting common stock, which is owned by Shareholder A (d%), Shareholder B (e%), and Shareholder C (d%). Distributing has outstanding b shares of voting preferred stock and c shares of nonvoting preferred stock, which is owned by Shareholder D.

Distributing wholly owns Controlled, a State A corporation, which is engaged in Business A. Distributing owns all of the outstanding voting and nonvoting common stock of Subsidiary, a State A corporation, which is directly engaged in Business A. Distributing also owns f% of Subsidiary's outstanding nonvoting preferred stock, and siblings of Shareholder D own the remaining n%.

Financial information has been received which indicates that Distributing (through Subsidiary) and Controlled have each had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Serious fundamental differences of opinion have arisen between Shareholder A and Shareholder B concerning the operations and overall objectives of the Business A activities conducted by Subsidiary and Controlled. Shareholder A, who has a conservative management style, manages the Business A activities of Subsidiary. Shareholder B, who has a more risk taking management style, manages the Business A activities of Controlled. The taxpayers believe that the Business A activities of Subsidiary and Controlled should be separated to avoid further conflicts arising from Shareholder A and Shareholder B's different management styles and business philosophies. Accordingly, the taxpayers have completed and will complete the following steps of a proposed transaction:

(i) Subsidiary has distributed residential real property ("Real Property") to Distributing with an adjusted basis and fair market value of $h.

(ii) Distributing has transferred the following assets to Controlled: cash in the amount of $i; a promissory note ("Note") payable between Distributing (payor) and Controlled (payee) in the amount of $j, bearing interest at the rate of o% per annum, and due on Date A; Real Property; notes receivable and accrued interest receivable from Shareholder B in the amount of $k and $l, respectively; and advances payable to Distributing in the amount of $m. These transfers were made to equalize the fair market value of the stock of Controlled with the fair market value of the shares of Distributing common stock owned by Shareholder B prior to the distribution.

(iii) Distributing will distribute all the outstanding Controlled stock to Shareholder B in exchange for all of Shareholder B's Distributing stock. No fractional shares of Controlled stock will be issued in the distribution.

The following representations have been made with respect to the steps described in subparagraphs (ii) and (iii) above:

(a) The fair market value of the Controlled stock to be received by Shareholder B will be approximately equal to the fair market value of the Distributing stock surrendered by Shareholder B in the exchange.

(b) 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.

(c) The five years of financial information submitted on behalf of Subsidiary and Controlled is representative of each corporation's present operations, and, with regard to each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(d) Immediately after the distribution, at least 90% of the fair market value of the gross assets of Distributing (through Subsidiary) will consist of the stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in section 355(b)(2) of the Internal Revenue Code.

(e) Following the distribution, Distributing (through Subsidiary) and Controlled will each continue the active conduct of Business A, independently and with its separate employees.

(f) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to avoid further conflicts arising from Shareholder A and Shareholder B's different management styles and business philosophies. The distribution of the stock of Controlled is motivated in whole or substantial part, by this corporate business purpose.

(g) 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 either Distributing or Controlled after the transaction.

(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.

(i) There is no plan or intention to liquidate either 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) No liabilities will be assumed in the transaction and no assets are being transferred subject to liabilities.

(k) No property is being transferred between Distributing and Controlled in which an investment tax credit determined under section 46 of the Code has been (or will be) claimed with respect to any of such property.

(l) No income items, such as accounts receivable, or any items resulting from a sale, exchange, or disposition that would have resulted in income to Distributing, or any items of expense, will be transferred to Controlled.

(m) There are no continuing, planned, or intended transactions between Distributing and Controlled following the distribution, either directly or indirectly, other than the continuing indebtedness described in Note above.

(n) 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 (See section 1.1502-13 and section 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; section 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account with respect to the Controlled stock will be included in income immediately before the distribution (See section 1.1502-19).

(o) Payments made in connection with all continuing transactions, if any, between the distributing and controlled corporations, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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

(q) No Distributing shareholder or shareholders will hold immediately after the Distribution disqualified stock with the meaning of section 355(d)(3) which constitutes a 50% or greater interest in Distributing or Controlled.

(r) The distribution is not part of a plan or series of related transactions (within the meaning of section 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 Controlled, or stock possessing 50% or more of the total value of all classes of stock of either Distributing or Controlled.

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

(1) The transfer by Distributing to Controlled of assets in exchange for Controlled stock, as described above, followed by the distribution of Controlled stock to Shareholder B in exchange for all of his stock in Distributing, will constitute a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled are each a "party to a reorganization" within the meaning of section 368(b).

(2) No gain or loss will be recognized to Distributing upon the transfer of assets to Controlled in exchange for Controlled stock (section 361(a)).

(3) No gain or loss will be recognized by Controlled on the receipt of the assets from Distributing in constructive exchange for additional shares of Controlled stock (section 1032(a)).

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

(5) The holding period of each Distributing asset received by Controlled will include the period during which that asset was held by Distributing (section 1223(2)).

(6) No gain or loss will be recognized by Distributing upon the distribution of all of the Controlled stock to Shareholder B, in exchange for all of his stock in Distributing as described above (section 361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder B upon receipt of the Controlled stock (section 355(a)(1)).

(8) The basis of the Controlled stock in the hands of Shareholder B will be the same as the basis of the Distributing stock exchange therefor (section 358(a)(1)).

(9) The holding period of the Controlled stock received by Shareholder B will include the holding period of the Distributing stock exchanged therefor, provided that the Distributing stock is held as a capital asset on the date of the distribution (section 1223(1)).

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

(11) Subsidiary will recognize gain upon the distribution of Real Property to Distributing under section 311(b). This gain will be taken into account when Real Property leaves the Distributing group upon the distribution of the Controlled stock to Shareholder B as described in (iii) above (section 1.1502-13(f)(7), Example 1(a) and (c)). The basis of Real Property will be the fair market value at the time it is distributed from Subsidiary to Distributing. See section 301(d) and Treas. Reg. 1.1502-13(f)(7), Example 1(a).

No opinion is expressed about the tax treatment of the 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 transaction that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. 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 letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to your authorized representative.

Sincerely yours,
Assistant Chief Counsel (Corporate)

By ____________________________
Mark S. Jennings
Senior Technician Reviewer, Branch 1