

## Internal Revenue Service

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## Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

**June 7, 2001**

### Legend

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

q% =

r% =

s% =

t% =

u% =

w% =

x% =

y% =

z% =

Date H =

Date J =

Date K =

State F =

Dear Sir or Madam:

This is in reply to your representative's letter of Date J, requesting rulings as to the federal income tax consequences of a proposed transaction. We have received additional information in a letter of Date K. The pertinent information submitted for consideration is summarized below.

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.

Distributing, a State F S corporation with only common stock outstanding, is engaged in business G in State F, and files its Federal income tax return on a fiscal year ending Date H. Shareholders A, B, C, D and E own q%, r%, s%, t% and u%, respectively, of Distributing's common stock. Controlled will be newly organized to carry out the proposed transaction.

Financial information submitted indicates that Distributing has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Disputes have arisen between Shareholders B and D (and their respective families) regarding the management, operation and direction of the ranching business. Consequently, the parties desire to separate the business into two parts to enable the disputants to own, manage and direct their portion of the divided business on their own. The proposal to implement the division so as to avoid further disputes is set forth below (the ATransaction@).

i. Distributing will transfer part of the property and liabilities (the ATransferred Property@) of the business to Controlled in exchange for all of Controlled=s common stock (the AContribution@).

ii. Immediately after the Contribution of the Transferred Property to Controlled, Distributing will distribute w% of the issued and outstanding Controlled common stock to Shareholder D, and x% of such stock to Shareholder E in exchange for all of such Shareholders= stock of Distributing.

iii. Shareholder A will receive y% of the common stock of Controlled in exchange for z% of the stock of Distributing. (Transaction steps ii and iii are referred to below as the ADistribution@.)

## REPRESENTATIONS

The taxpayer has made the following representations concerning the Contribution and Distribution:

(a) The fair market value of the Controlled stock and other consideration to be received by each of Shareholders A, D, and E will be approximately equal to the fair market value of the Distributing stock surrendered by each in the exchange.

(b) No part of the consideration distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a Distributing shareholder.

(c) The five years of financial information submitted on behalf of Distributing represents its present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.

(d) Following the Distribution, 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 conducted by Distributing before the Distribution.

(e) The Distribution is being carried out to end the shareholder disputes. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(f) There is no plan or intention by the Distributing shareholders to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the Distribution.

(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 Distribution, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

- (h) 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.
- (i) The total adjusted bases and the fair market value of the assets transferred by Distributing in the Contribution will, in each instance, equal or exceed the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (j) The liabilities assumed in the Contribution 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 section 47(d) applies) is transferred will be adjusted pursuant to section 50(a)(1) or (a)(2) (or section 47, as in effect before amendment by Public Law 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 transaction.
- (m) No income items, including accounts receivable or any item resulting from a sale, exchange or disposition of property, that would have resulted in income to Distributing, and no items of expense will be transferred to Controlled if Distributing has earned the right to receive the income or could claim a deduction for the expense under the accrual or similar method of accounting.
- (n) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.
- (o) Payments made in connection with any continuing transactions 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.
- (p) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (q) 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 percent or more of the combined voting power of all classes of either Distributing or Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of either Distributing or Controlled stock.
- (r) Distributing is an S corporation (within the meaning of section 1361(a)). Controlled will elect to be an S corporation pursuant to section 1362(a) on the first available date after the distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

(s) The Transaction will not result in any reduction in federal taxes of Distributing or Controlled and any non-corporate business purpose which results from the division of Distributing is merely incidental.

(t) Distributing and Controlled have no accumulated earnings and profits nor will either corporation have any current earnings and profits as of the date of the Distribution.

(u) No distribution of property by Distributing immediately before the Transaction would require recognition of gain resulting in current earnings and profits for the taxable year of the Distribution.

(v) Distributing is not aware of, nor is Distributing planning or intending, any event that will result in Distributing or Controlled having positive current or accumulated earnings and profits after the Distribution.

(w) Less than fifty percent (50%) of the total combined voting power of all classes of Distributing stock entitled to vote and less than fifty percent (50%) of the total value of shares of all classes of Distributing stock will have been acquired by purchase under section 355(d)(5) or (8) during the five-year period ending on the date of distribution (determined after applying section 355(d)(6)).

## RULINGS

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

(1) The Contribution, followed by the Distribution, will be a reorganization under section 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under section 368(b).

(2) No gain or loss will be recognized by Distributing on the Contribution (section 361(a) and section 357(a)).

(3) No gain or loss will be recognized by Controlled on the Contribution (section 1032(a)).

(4) The basis of each asset received by Controlled will equal the basis of that asset in the hands of Distributing immediately before the transfer (section 362(b)).

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

(6) No gain or loss will be recognized by Distributing on the Distribution (361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Shareholders A, D or E on the Distribution (section 355(a)(1)).

(8) The basis of Controlled stock in the hands of Shareholders A, D, and E will in each case equal the basis of the Distributing stock surrendered in exchange therefor (section 358(a)(1)).

(9) The holding period of Controlled stock received by Shareholders A, D and E will include the holding period of the Distributing stock surrendered in the exchange, provided the Distributing stock is held as a capital asset on the date of the Distribution (section 1223(1)).

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

#### CAVEATS AND PROCEDURAL STATEMENTS

(1) No opinion is expressed about the tax treatment of the Transaction under other provisions of the Code or regulations or 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.

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

(3) Each taxpayer involved in this Transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the Transaction covered by this letter is completed.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Associate Chief Counsel (Corporate)

By: Gerald B. Fleming

Senior Technician Reviewer, Branch 2