

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

**Telephone Number:**

Refer Reply To:  
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Date:  
June 4, 2002

Distributing =

Controlled =

Business X =

City Y =

City Z =

A =

B =

C =

d =

e =

Dear

This letter responds to your January 16, 2002 request for rulings on certain federal income tax consequences of a proposed transaction. The information in that request and in later correspondence is summarized below.

**Summary of Facts**

Distributing is an S corporation engaged in Business X. All of Distributing's stock is voting common and is presently owned by A.

We have received financial information indicating that Distributing's Business X, has had gross income and operating expenses representing the active conduct of a trade or business during each of the past five years.

Distributing conducts its business in City Y and City Z. B and C are the general managers of the City Z branch and wish to acquire an equity interest in Distributing's City Z operations but not in its City Y operations.

### **Proposed Transaction**

In order to enable B and C to acquire an equity interest in the City Z operations, the following transaction is proposed:

(i) Distributing will transfer all of the assets of the Business X operations provided in City Z to newly formed Controlled in exchange for Controlled voting stock and the assumption by Controlled of related liabilities (the "Contribution").

(ii) Distributing will distribute the Controlled stock to A (the "Distribution").

(iii) B and C each will purchase for fair market value sufficient Controlled stock from Controlled to give each d percent of the Controlled stock. B and C will purchase the stock under an installment agreement under which the purchase price will be repaid over ten years. B and C each will purchase e percent of the Controlled stock within one year of the Distribution.

### **Representations**

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

(a) The indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

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

(c) The five years of financial information submitted on behalf of Distributing represents Distributing's present operations, and with regard to such business, there has been no substantial operational change since the last financial statement submitted.

(d) Following the transaction, Distributing and Controlled each 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 before the consummation of the transaction.

(e) The Distribution is being carried out to provide B and C with significant equity interests in Distributing's City Z operations. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

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

(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 transaction, other than through stock purchases meeting the requirements of § 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 basis and the fair market value of the assets transferred to Controlled by Distributing will each equal or exceed the liabilities assumed (as determined under § 357(d)) by Controlled.

(j) The liabilities assumed (as determined under § 357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

(k) Payments made in 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.

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

(m) The Distribution is not part of a plan (or series of related transactions) within the meaning of § 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 stock of Distributing or Controlled entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing or Controlled stock.

(n) Distributing is an S corporation within the meaning of § 1361(a). Controlled will elect to be an S corporation pursuant to § 1362(a) on the first available date after the Distribution, and there is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

## Rulings

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

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

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

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

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

(5) The holding period of each asset received by Controlled will include the holding period of that asset in the hands of Distributing (§ 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) A on A’s receipt of Controlled stock in the Distribution (§ 355(a)(1)).

(8) The aggregate basis of the Controlled and Distributing stock in the hands of A after the Distribution will equal A’s basis in the Distributing stock held immediately before the Distribution (§ 358(a)(1)). The basis will be allocated between the Controlled and Distributing stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) of the Income Tax Regulations (§ 358(b)(2) and (c)).

(9) The holding period of the Controlled stock received by A will include the holding period of the Distributing stock on which the Distribution is made, provided the stock is held by A as a capital asset on the date of the Distribution (§ 1223(1)).

(10) Earnings and profits will be allocated between Distributing and Controlled in accordance with sections 312(h) and 1.312-10(a).

## Caveats

No opinion is expressed about the tax treatment of the proposed 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.

### **Procedural Statements**

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

Each taxpayer involved in the 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.

Under a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

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Lewis K Brickates  
Acting Chief, Branch 4  
Office of Associate Chief Counsel  
(Corporate)