

Internal Revenue Service

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Date:

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LEGEND:

Distributing =

Controlled =

Business Z =

Asset Y =

a =

b =

c =

A =

B =

C =

D =

E =

F =

Dear

This letter responds to your September 10, 2003 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in subsequent correspondence 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 these facts or representations, but such verification may be required as part of the audit process.

Summary of Facts

Distributing is a closely held corporation owned by two family shareholder groups. Shareholders A, B, and C ("Family A") own a percent of Distributing and shareholders D, E, and F ("Family B") own the remaining b percent.

Distributing directly engages in Business Z. Distributing has submitted financial information indicating that Business Z has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Family A and Family B have disagreed on a number of fundamental matters relating to Distributing's business. The conflicts between Family A and Family B are having an adverse effect on the day-to-day operations of Distributing.

Proposed Transaction

To eliminate the shareholder disputes, Distributing has proposed the following series of steps (collectively, the "Proposed Transaction"):

(i) Distributing will transfer Business Z's Asset Y to newly formed Controlled in exchange for all of the voting stock of Controlled, the assumption by Controlled of liabilities related to Asset Y, and \$c (the "Contribution").

(ii) Distributing will distribute all of the Controlled stock to Family A in exchange for all of their Distributing stock (the "Distribution").

Representations

The taxpayer has made the following representations concerning the Proposed Transaction:

(a) The fair market value of the Controlled stock received by Family A will approximately equal the fair market value of the Distributing stock surrendered by Family A in the exchange.

(b) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing will equal or exceed the liabilities assumed (as determined under § 357(d)) by Controlled plus the fair market value of any other property distributed to its shareholders in pursuance of the plan of reorganization or to its creditors in connection with the reorganization.

(c) The liabilities assumed (as determined under § 357(d)) 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.

(d) 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.

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

(f) Following the transaction, Distributing and Controlled each will 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 consummation of the transaction.

(g) The Distribution is carried out for the following corporate business purpose: to allow Family A and Family B to each go their own separate ways. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(h) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

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

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

(k) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.

(l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(m) 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.

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

(o) There is no acquisition of stock of Distributing or Controlled (including any predecessor or successor of any such corporation) that is part of a plan or a series of related transactions (within the meaning of § 1.355-7T) that includes the distribution of Controlled stock.

Rulings

Based solely upon 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” within the meaning of § 368(b).

(2) Gain, if any, will be recognized by Distributing on the Contribution in an amount not exceeding the amount of cash received by Distributing (§§ 357(a), 361(a), and 361(b)(1)(B)). No loss will be recognized (§ 361(b)(2)).

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

(4) The basis that Controlled has in each asset received from Distributing will equal the basis of that asset in the hands of Distributing, increased by any gain recognized by Distributing on the Contribution (§ 362(b)).

(5) The holding period for each asset received by Controlled from Distributing will include the period during which Distributing held the asset (§ 1223(2)).

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

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Family A upon their receipt of Controlled stock in exchange for their Distributing stock (§ 355(a)).

(8) The basis of the Controlled stock in the hands of Family A after the Distribution will, in each instance, equal the basis of the respective Distributing stock surrendered by the shareholder in exchange therefor (§ 358(a)(1)).

(9) The holding period of the Controlled stock received by Family A will, in each instance, include the holding period of the respective Distributing stock surrendered by the shareholder, provided such stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(10) Proper allocation of Distributing’s earnings and profits will be made under §§ 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 and 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.

In particular, we have not reviewed or verified any information submitted by the taxpayer in support of its representations that (i) the Distribution satisfies the business purpose requirement of § 1.355-2(b), (ii) the Proposed Transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both, and (iii) the Distribution and an acquisition or acquisitions are not part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii).

Procedural Statements

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

Each taxpayer involved in the Proposed Transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the proposed transaction is completed.

Under a power of attorney on file in this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Corporate)

cc: