

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:3 PLR-160262-01

Date:

March 6, 2002

Distributing =

Controlled =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Business A =

Location 1 =

Location 2 =

a =

b =

d =

e =

f =

g =

h =

i =

j =

State X =

Dear :

This letter responds to your request dated October 23, 2001, for rulings on the federal income tax consequences of a proposed transaction. You submitted additional information in letters dated December 21, 2001, January 23, 2002, February 8, 2002 and February 22, 2002. The information submitted for consideration is summarized below.

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Distributing, a State X corporation, uses the cash receipts and disbursements method of accounting and has a calendar tax year. Distributing's only class of outstanding stock consists of a shares of common stock which is held as follows:

Shareholder 1	=	<u>b</u>
Shareholder 2	=	<u>b</u>
Shareholder 3	=	<u>d</u>
Shareholder 4	=	<u>e</u>
Shareholder 5	=	<u>f</u>

Shareholder 4 and Shareholder 5 are husband and wife. Shareholder 1, Shareholder 2, and Shareholder 3 are the children of Shareholder 4 and Shareholder 5.

Distributing is engaged in Business A which has two locations, Location 1 and Location 2. The two locations differ geographically and operationally.

We have received financial information which indicates that Business A has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

In order to eliminate management problems arising from the geographic and operational separation of Distributing's Location 1 and Location 2, the following transaction has been proposed:

- (i) Shareholder 1 will purchase one-half Shareholder 2's stock in Distributing for a total sales price of \$ g to be paid by a note amortized over a h year term with an i-year balloon at an initial interest rate of j percent.
- (ii) Distributing will form a new corporation (Controlled) as a State X corporation. Controlled will use the cash receipts and disbursements method of accounting and have a calendar tax year.
- (iii) Distributing will transfer Location 1 and certain related equipment to Controlled in exchange for all of the stock of Controlled. Controlled is not assuming liabilities or receiving assets subject to liabilities.
- (iv) Distributing will distribute all of the Controlled stock to Shareholder 1 in exchange for all of Shareholder 1's Distributing stock.

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

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- (a) The fair market value of the Controlled stock and other consideration to be received by Shareholder 1 will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by Shareholder 1 as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing is representative of the corporation'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.
- (d) Following the transaction, 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 prior to consummation of the transaction.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purpose: To eliminate management problems arising from the geographic and operational separation of Distributing's Location 1 and Location 2. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) 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 intent to revoke or otherwise terminate the S corporation election of Distributing or Controlled.
- (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 § 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) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.

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- (l) 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.
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) 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 total combined voting power of all classes of stock of Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.
- (o) Immediately after the distribution, no person will hold "disqualified stock" in Distributing or Controlled, which constitutes a 50 percent or greater interest in such corporations within the meaning of § 355(d).

Based solely on the information submitted and representations made, we hold as follows:

- (1) The transfer by Distributing of Location 1 and certain related equipment to Controlled solely in exchange for all of the stock of Controlled, followed by the distribution of the Controlled stock to Shareholder 1 in exchange for all of Shareholder 1's Distributing stock, as described above, will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of Location 1 and certain related equipment to Controlled in exchange for Controlled stock, as described above (§ 361(a)).
- (3) Controlled will recognize no gain or loss on the receipt of Location 1 and certain related equipment in exchange for Controlled stock, as described above (§ 1032(a)).
- (4) Controlled's basis in each asset received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (5) Controlled's holding period for each asset received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).
- (6) Distributing will recognize no gain or loss on the distribution of the Controlled stock to Shareholder 1 (§ 361(c)).

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- (7) Shareholder 1 will recognize no gain or loss (and no amount will be included in the income of Shareholder 1) upon the receipt of the Controlled stock in exchange for all of Shareholder 1's Distributing stock, as described above (§ 355(a)(1)).
- (8) Shareholder 1's basis in the Controlled stock received in the transaction will equal the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).
- (9) Shareholder 1's holding period of the Controlled stock received in the transaction will include the holding period of the Distributing stock surrendered in exchange therefor, provided that Shareholder 1 held the Distributing stock as a capital asset on the date of the distribution (§ 1223(1)).
- (10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) of the Income Tax Regulations.

We express no opinion about the tax treatment of the proposed transaction under other provisions of the Internal Revenue 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. Specifically, no opinion is expressed concerning the tax consequences in step (i), above.

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

It is important that a copy of this letter 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.

Sincerely yours,
Richard E. Coss
Assistant to the Branch Chief, Branch 3
Office of Associate Chief Counsel
(Corporate)

cc: