

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

**CC:CORP:BO6-PLR-152087-02**

Date:

**December 18, 2002**

### LEGEND

Distributing =

Controlled =

Business 1 =

Business 2 =

State A =

Date 1 =

Shareholder A =

a =

b =

c =

d =

e =

Dear :

This letter responds to your September 12, 2002 request for rulings regarding certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondences dated October 9, 2002, November 12, 2002 November 21, 2002 and December 6, is summarized below.

PLR-152087-02

Distributing was incorporated as a Subchapter C corporation in State A on Date 1. Distributing directly conducts Business 1 and Business 2.

Distributing has 2 classes of common stock issued and outstanding. Those 2 classes are voting common stock ("Class I common stock" and "Class II common stock"). The Class II shares are only issued to State A Business 1 agents and may only be sold back to Distributing by those agent/shareholders.

Distributing currently has a shares of Class I common stock issued and outstanding. This stock is owned by b shareholders. Of these shareholders, Shareholder A owns 5% or more of such stock.

Distributing currently has c shares of Class II common stock issued and outstanding. The Class II common stock is owned by d shareholders who are all unrelated. No shareholder owns 5 percent or more of the Class II common stock. The Class II common stock constitutes less than e% of the total vote and value of the Distributing common stock issued and outstanding.

Financial information has been received indicating that Distributing has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing wishes to reduce the cumbersome and expensive multiple state regulatory burden on Business 2 caused by Distributing being involved in Business 1. In addition, Distributing management believes that the close relationship between Business 1 and Business 2 continuously puts Business 2 at a disadvantage with respect to competition. The taxpayers have shown that a separation of Business 1 from Business 2 will eliminate the above mentioned burdens, as well as result in other significant cost savings. Accordingly, the taxpayer has proposed the following transaction:

- (i) Distributing will form Controlled as a State A corporation.
- (ii) Distributing will transfer to Controlled all of the assets and liabilities of Business 2 and certain investment assets in exchange for voting Controlled stock. Distributing will then hold all of the stock of Controlled.
- (iii) Distributing will distribute all of the Controlled voting stock pro rata to the Class I common stock shareholders of Distributing.
- (iv) No securities other than stock of Controlled are being exchanged in the transaction.

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

PLR-152087-02

- (a) No part of the consideration to be distributed by the Distributing corporation will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (b) The 5 years of financial information submitted on behalf of the Distributing corporation is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) The distribution of the stock, or stock and securities, of the Controlled corporation is carried out for the following corporate business purposes: (1) To reduce the cumbersome and expensive regulatory burden on Business 2 caused by Business 1 being subject to multiple state regulatory oversight. (2) To eliminate the close relationship between Business 1 and Business 2 that has continuously put Business 2 at a disadvantage with respect to competition.
- (d) There is no plan or intention by the shareholders or security holders of the Distributing corporation to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either the Distributing or Controlled corporation after the transaction.
- (e) Except for Class II common stock (such stock constitutes less than 9 % of the total vote and value of the Distributing common stock issued and outstanding) which Distributing may purchase from the Business 1 agents upon their leaving Distributing, there is no plan or intention by either the Distributing corporation or the Controlled corporation, 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.
- (f) There is no plan or intention to liquidate either the Distributing or Controlled corporation, 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.
- (g) For purposes of Section 355(d), immediately after the distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date.
- (h) For purposes of Section 355(d), immediately after the distribution, no person

PLR-152087-02

(determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date.

- (i) The distribution is not a 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 fifty percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing fifty percent or more of the total value of all classes of stock of either Distributing or Controlled.
- (j) The total adjusted bases and the fair market value of the assets transferred to the Controlled corporation by the Distributing corporation each equals or exceeds the sum of the liabilities assumed by the Controlled corporation (as determined under section 357(d)).
- (k) The liabilities assumed in the transaction (as determined under section 357(d)) were incurred in the ordinary course of business and are associated with the assets being transferred.
- (l) The Distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (m) 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 Treas. Reg. Sections 1.1502-13 and 1.1502-14 as in effect before the publication of T. D. 8597, 1995-32 I.R.B. 6, and as currently in effect; Treas. Reg. section 1.1502-13 as published by T.D. 8597). Further, Distributing does not have an excess loss account with respect to Controlled stock.
- (n) Payments made in connection with all continuing transactions, if any, between the Distributing and Controlled corporation, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (o) No intercorporate debt will exist between the Distributing corporation and the Controlled corporation at the time of, or subsequent to, the distribution of the Controlled corporation stock.

PLR-152087-02

- (p) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (q) The gross assets of the trades or businesses that will be relied upon by Distributing and Controlled to satisfy the active trade or business requirement of § 355(b) will, in the aggregate, have a fair market value that is not less than five percent of the total fair market value of the gross assets of the company directly operating such trades or businesses.
- (r) The Distributing corporation is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by the Distributing or Controlled corporation to make an S corporation election pursuant to § 1362(a).
- (s) Following the transaction, the Distributing and Controlled corporation will each continue the active conduct of its business, independently and with its separate employees.
- (t) The indebtedness owed by the Controlled corporation to the Distributing corporation after the distribution of the Controlled corporation stock will not constitute stock or securities.

Based solely on the information submitted and the representations made, we have concluded that:

- (1) The transfer by Distributing of Business 2 assets, as well as investment assets, to Controlled in exchange for all of the Controlled stock and the assumption by Controlled of certain liabilities associated with the Business 2 assets transferred, followed by the pro rata distribution by Distributing of all the Controlled stock to the Distributing shareholders, will constitute a reorganization within the meaning of section 368(a)(1)(D) of the Internal Revenue Code. Distributing and Controlled will each be a “party to the reorganization” within the meaning of section 368(b).
- (2) No gain or loss will be recognized by Distributing upon its receipt of Controlled stock in exchange for the transfer of assets to, and the assumption of liabilities by, Controlled. Section 361(a) and (b)(1) and section 357(a).
- (3) No gain or loss will be recognized by Controlled upon its receipt of assets in exchange for its issuance of shares of Controlled stock. Section 1032(a).
- (4) Controlled’s basis in the assets received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transfer. Section 362(b).

PLR-152087-02

- (5) The holding period of each asset received by Controlled from Distributing will include the period during which Distributing held such asset. Section 1223(2)
- (6) Distributing will not recognize gain or loss upon the distribution of the stock in Controlled to the Distributing shareholders. Section 361(c)(1).
- (7) No gain or loss will be recognized to (and no amounts will be included in the income of) the Distributing shareholders upon their receipt of Controlled stock. Section 355(a)(1).
- (8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of the Distributing shareholders after the distribution will equal the aggregate adjusted basis of the Distributing stock held immediately before the distribution, allocated in proportion to the fair market value of each under Treas. Reg. section 1.358-2(a)(2).
- (9) The holding period of the Controlled stock received by the Distributing shareholders will, in each instance, include the holding period of the Distributing stock with respect to which the distribution will be made, provided that the Distributing stock is held as a capital asset on the day 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 in accordance with Treas. Reg. sections 1.312-10(a) and 1.1502-33.

We express no opinion about the tax treatment of the transaction under any other section of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered in the above rulings.

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.

The 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.

A copy of this ruling letter should be attached to the federal income tax return of each taxpayer involved for the taxable year in which the transaction is consummated.

PLR-152087-02

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

Sincerely yours,

*Reginald Mombrun*

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Assistant to the Branch Chief, Branch 6  
Office of Associate Chief Counsel  
(Corporate)