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Department of the Treasury

Washington, DC 20224

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June 10, 2003

Distributing =

State A =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder D Trust =

Shareholder E =

Shareholder E Trust =

Shareholder F =

Shareholder G =

Shareholder H =

Shareholder I =

Controlled =

Business A =

Dear :

This letter responds to a letter dated February 12, 2003, requesting rulings concerning the federal income tax consequences of a proposed transaction. The information submitted in that and subsequent correspondence is summarized below.

Distributing, a State A corporation, is a C corporation that uses the cash method of accounting and a calendar year. Distributing is primarily engaged in Business A. Distributing has outstanding common stock, 50 percent held by Shareholders A, B, and C (the "ABC Group"), and 50 percent held by Shareholders D through I (the "DI Group"). Distributing has no securities outstanding. Shareholders A and D hold directly, or indirectly within the meaning of § 318(a) of the Internal Revenue Code, all of the stock in Distributing and these two shareholders have been engaged in both the managerial and operational activities of Distributing for many years.

Controlled, a new corporation being formed under the laws of State A, will be a C corporation that uses the cash method of accounting and a calendar year. Controlled will have outstanding solely common stock. Initially, all the outstanding stock in Controlled will be held by Distributing.

Shareholders A and B are husband and wife. Shareholder C is their son. The ABC Group desires for Distributing to continue business operations substantially unchanged except for management of the business gradually being transferred to Shareholder C. In contrast, the DI group believe Shareholder C is too young to manage Distributing's operations and want to hire a professional manager. The DI Group wants

Distributing to make adjustments in its business so that, while continuing in Business A, it expands into more profitable related areas. As a result of this philosophical difference between the equal shareholder groups, it is becoming increasingly difficult to maintain a consistent business strategy for Distributing. It is now desired to divide Distributing between the ABC and DI Groups, in order to have two companies, each of which will have its own consistent business strategy and, thus, the potential to function more effectively.

The parties have already completed or intend to complete the following steps ("Steps") in the proposed transaction:

- (I) Distributing will form Controlled which will have outstanding solely voting common stock.
- (II) Distributing will transfer to Controlled approximately one half in value of both its real property and its other business assets. Controlled will not assume any liabilities in the transaction and none of the assets received by Controlled will be subject to any liability.
- (III) Distributing will distribute all the Controlled stock to the ABC Group in exchange for this group's surrender of all their stock in Distributing. Each shareholder of the ABC Group will receive one share of Controlled stock in exchange for each share of stock in Distributing. (Following this step, the DI Group will own all the outstanding stock in Distributing and the ABC Group will own all the outstanding stock in Controlled.)

The following representations have been made in connection with the proposed Steps (I) through (III) above:

- (a) Distributing, Controlled, and each of the shareholders will each pay their own expenses in the transaction.
- (b) Controlled will not be indebted to Distributing after the distribution of Controlled stock.
- (c) There is no plan or intention for Controlled to have outstanding any warrants, or options, or for Controlled to have outstanding any debt that would constitute either a security or an equity interest in Controlled.
- (d) For each of Shareholders A, B, and C, the fair market value of the Controlled stock received will approximately equal the fair market value of the Distributing stock surrendered by the shareholder in exchange therefor.

- (e) No part of the Controlled stock received by the shareholders in the Step (III) distribution is being received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (f) The 5 years of financial information submitted on behalf of Business A is representative of the corporation's present operations and there have been no substantial operational changes since the date of the last financial statements submitted.
- (g) 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.
- (h) The Step (III) distribution of Controlled stock is being undertaken for the corporate business purpose of ending the present shareholder disagreements and inconsistent business strategy for Distributing, and so that each of the resultant companies can pursue a single consistent business strategy. The distribution of Controlled stock is motivated in substantial part by this management consistency corporate business purpose.
- (i) 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.
- (j) 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, or securities of, either Distributing or Controlled after the proposed transaction except for possible transfers by gift having a value within the § 2503(b) exclusion or, ultimately, bequest to members of the same family as defined in § 267(c)(4).
- (k) 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, except for: (i) dispositions in the ordinary course of business; and (ii) transfers described in Step (II).
- (l) Distributing has not, and will not, accumulate its receivables or make extraordinary payments of its payables in anticipation of this transaction.

- (m) No intercorporate debt will exist between Distributing and Controlled at the time of the proposed transaction, or subsequent thereto, except for any temporary accounts payable that may arise in the course of routine business transactions between the companies.
- (n) It is not anticipated that any substantial business transactions will occur between Distributing and Controlled. However, with regard to any inter-company transactions, all payments between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arms length.
- (o) No two parties to the Step (II) transfer are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (p) The Step (III) spinoff will not constitute a disqualified distribution within the meaning of § 355(d).
- (q) The Step (III) spin-off 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 in either Distributing or Controlled entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock in either Distributing or Controlled.

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

- (1) The transfer in Step (II) by Distributing to Controlled of Business A and other assets, in exchange for all the stock in Controlled followed by the distribution in Step (III) of all the Controlled stock to Shareholders A, B, and C, as described above, constitutes a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled are each a “party to a reorganization” within the meaning of § 368(b).
- (2) No gain or loss is recognized by Distributing on the transfer of assets, to Controlled in exchange for all the stock in Controlled (§§ 361(a) and 357(a)).
- (3) No gain or loss is recognized by Controlled on its receipt of assets in exchange for Controlled stock (§ 1032(a)).
- (4) Controlled’s basis in the assets received from Distributing equals the basis of such assets in the hands of Distributing immediately prior to the transfer

(§ 362(b)).

- (5) Controlled's holding period for assets received from Distributing includes the period during which Distributing held such assets (§ 1223(2)).
- (6) No gain or loss will be recognized to Distributing upon the distribution to Shareholders A, B, and C of all the stock in Controlled (§ 361(c)(1)).
- (7) No gain or loss will be recognized to (and no amount will be included in the income of) Shareholders A, B, or C upon the receipt of Controlled stock (§ 355(a)).
- (8) For each shareholder, the basis of the Controlled stock received will be equal to the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).
- (9) The holding period of the Controlled stock received by a shareholders will include the period during which such shareholder held the Distributing stock exchanged therefor, provided that the Distributing stock is a capital asset in the hands of the shareholder on the date of the exchange (§ 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).

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings.

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

In accordance with a power of attorney on file in this office, a copy of this letter is being sent to the taxpayer's representative.

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 transactions covered by this letter are consummated.

Sincerely,

Debra L. Carlisle
Debra L. Carlisle
Chief, Branch 5
Office of Associate Chief Counsel
(Corporate)

cc: