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Date:

November 26, 2003

LEGEND:

Distributing =

Controlled =

State A =

Business A =

Family Group X =

Family Group Y =

Z =

Dear :

We respond to your letter dated July 7, 2003, for rulings concerning the Federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated October 29, 2003, and November 24, 2003. The material information submitted for consideration is summarized below.

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Distributing is a State A corporation that is engaged in Business A. Distributing files a Federal income tax return with a z year end using an accrual method of accounting. Family Group X and Family Group Y each own one half of the outstanding stock of Distributing. The primary shareholders within Family Group X and Family Group Y are brother and sister.

Controlled is a to-be-formed State A corporation. Controlled will have a calendar year end for Federal income tax purposes and will use an accrual method of accounting.

Financial information has been received that 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 addition to being the sole shareholders of Distributing, members of Family Group X and Family Group Y are the primary employees of Distributing and are involved in the day to day management of Business A. For some time, intractable disputes have arisen between Family Group X and Family Group Y over the best way to manage Business A. To resolve these differences, the two families propose to divide the assets of Distributing as follows:

- (i) Distributing will transfer to Controlled property and cash, if necessary to equalize the value of Distributing and Controlled (the "Contribution"). In exchange, Controlled will issue all of the Controlled stock to Distributing. No liabilities will be assumed by Controlled and Controlled will not receive any assets subject to a liability, unless a property to be contributed to Controlled must be mortgaged in order to raise cash to equalize the values of Distributing and Controlled. In no case would liabilities assumed by Controlled exceed the tax basis in the properties transferred.
- (ii) Distributing will distribute all of the Controlled stock to Family Group X in exchange for all of their stock in Distributing (the "Distribution").

After the Distribution, both Distributing and Controlled will continue to operate their respective share of Business A separately and independently. It is possible that Distributing and Controlled will temporarily retain an interest in one piece of property following the Distribution due to the difficulties in valuing the property for transfer or sale.

The parties have submitted the following representations in connection with the proposed transaction:

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- (a) The fair market value of the controlled corporation stock to be received by each shareholder of the distributing corporation will be approximately equal to the fair market value of the distributing corporation stock surrendered by the shareholder in the exchange.
- (b) 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.
- (c) The five 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.
- (d) Following the transaction, the distributing and controlled corporations will each continue the active conduct of its share of all the integrated activities of Business A conducted by the distributing corporation prior to consummation of the transaction, independently and with its separate employees.
- (e) The distribution of the stock of the controlled corporation is carried out for the following corporate business purpose: to eliminate shareholder disputes that, if permitted to continue, would jeopardize the operation and continued success of the corporate business. The distribution of the stock of the controlled corporation is motivated, in whole or substantial part, by this corporate business purpose.
- (f) There is no plan or intention by the shareholders of the distributing corporation to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either the distributing or controlled corporation after the transaction.
- (g) 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.
- (h) There is no plan or intention to liquidate either the distributing or controlled corporation, to merge either corporation with any other corporation, or to

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sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.

- (i) No investment credit has been claimed on properties to be transferred from Distributing to Controlled, and Controlled will not claim investment credit on any of the properties to be received.
- (j) The distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (k) 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.
- (l) Payments made in connection with all continuing transactions, if any, between the distributing and controlled corporations, 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 Section 368(a)(2)(F)(iii) and (iv).
- (n) The interest of Distributing in the one remaining parcel of jointly held property will be sold or otherwise disposed of as soon as practicable after the Distribution, but in no event later than 18 months after the date of the Distribution.
- (o) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing in the Contribution will, in each instance, equal or exceed the liabilities assumed (as determined under § 357(d) of the Internal Revenue Code), if any, by Controlled.
- (p) The liabilities to be assumed (as determined under § 357(d)), if any, in the Contribution were incurred in the ordinary course of business and are associated with the assets transferred.
- (q) 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 either Distributing or Controlled or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

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

- (1) The transfer by Distributing to Controlled of approximately half of the assets associated with Business A in exchange for all of the outstanding stock of Controlled and the assumption of liabilities, if any, followed by the distribution of all of the outstanding stock of Controlled to the members of Family Group X in exchange for all of their stock in Distributing, as described above, will be a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be “a party to a reorganization” within the meaning of section 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of the Distributing assets to Controlled in exchange for all of the outstanding stock of Controlled and the assumption of liabilities, if any, as described above (sections 357(a) and 361(a)).
- (3) Controlled will recognize no gain or loss on the receipt of assets of Distributing in exchange for the Controlled stock, as described above (section 1032(a)).
- (4) Controlled’s basis of the assets received will be the same as the basis of such assets in the hands of Distributing immediately prior to the exchange (section 362(b)).
- (5) Controlled’s holding period for each asset received from Distributing will include the period during which such asset was held by Distributing (section 1223(2)).
- (6) No gain or loss will be recognized to Distributing upon the Distribution, as described above (section 361(c)(1)).
- (7) No gain or loss shall be recognized to (and no amount shall be includible in the income of) the shareholders of Distributing (the members of Family Group X) upon their receipt of the stock of Controlled in exchange for their Distributing stock (section 355(a)(1)).
- (8) The basis of Controlled stock in the hands of each member of Family Group X after the distribution will equal the basis of the Distributing stock surrendered by each such shareholder in exchange therefor (section 358(a)(1)).

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- (9) The holding period of the Controlled stock received by each member of Family Group X will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset on the date of the distribution (section 1223(1)).
- (10) As provided in section 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with regulation section 1.312-10(a).

Except as expressly provided herein, no opinion is expressed or implied concerning the Federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

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

Sincerely,

Richard E. Coss

Richard E. Coss
Senior Counsel, Branch 3
Office of Associate Chief Counsel

(Corporate)