

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Refer Reply To:  
CC:CORP:1 – PLR-147034-03

Date:  
December 11, 2003

Distributing =

Controlled =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Shareholder 6 =

Shareholder 7 =

Shareholder 8 =

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Shareholder 9 =

Shareholder 10 =

Shareholder 11 =

Business A =

State X =

Year A =

a =

b =

c =

d =

e =

f =

g =

h =

i =

i =

k =

l =

m =

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n =

Dear

We reply to your letter dated July 3, 2003, requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated October 12, October 31, November 17, and December 4, 2003. The information submitted for consideration is summarized below.

Distributing is a State X corporation that utilizes the cash method of accounting. Distributing currently has two classes of shares, voting and non-voting, outstanding, which are owned by eleven shareholders (collectively the "Shareholders"). The outstanding shares are held as follows: Shareholder 1 (a%); Shareholder 2 (b%); Shareholder 3 (c%); Shareholder 4 (d%); Shareholder 5 (e%); Shareholder 6 (f%); Shareholder 7 (g%); Shareholder 8 (h%); Shareholder 9 (i%); Shareholder 10 (j%); and Shareholder 11 (k%). Shareholders 1, 2, and 3 (collectively referred to as "Shareholder Group I") have a combined ownership of l% of Distributing stock. Shareholders 4 through 11 (collectively referred to as "Shareholder Group II") have a combined ownership of m% of Distributing stock.

Distributing has directly engaged in Business A since its formation. The taxpayer has supplied financial information which indicates that Distributing has been conducting a business that has had gross receipts and operating expenses representative of the active conduct of the business for each of the past five years.

Disputes have arisen between Shareholder Group I and Shareholder Group II that are negatively impacting Business A. Shareholder Group II wishes to expand part of Business A, while Shareholder Group I prefers to make the existing business more profitable without expansion. The difficulties created by this difference in philosophies, goals, and desires have caused, and will continue to cause, a stalemate as to any future corporate growth. To eliminate these disputes, the taxpayers propose the following transaction ("Proposed Transaction"):

- (i) Distributing will form Controlled under the laws of State X as a cash basis, subchapter C corporation.
- (ii) Distributing will transfer n% of its assets, as described in the submission, to Controlled, and Controlled will assume n% of Distributing's liabilities in exchange for all of the shares of stock of Controlled.

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- (iii) Distributing will distribute all of the stock of Controlled to Shareholder Group II in exchange for all of Shareholder Group II's stock in Distributing.
- (iv) Distributing will hire an employee to help perform the integrated activities of Business A to be conducted by Distributing after to the consummation of the transaction.

The following representations have been made in connection with the Proposed Transaction:

- (a) There will be no debt outstanding between Distributing and Controlled after the Proposed Transaction.
- (b) The fair market value of the stock of Controlled to be received by Shareholder Group II will be approximately equal to the fair market value of the Distributing corporation stock surrendered by such Shareholders in the exchange.
- (c) No part of the consideration to be distributed by Distributing will be received by a Shareholder as a creditor, employee or in any capacity other than that as a shareholder of Distributing.
- (d) The five years of financial information submitted on behalf of Distributing 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.
- (e) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of all of the integrated activities of Business A conducted by Distributing prior to the consummation of the transaction.
- (f) The distribution of stock of Controlled is being carried out for the following corporate business purposes: (i) resolution of shareholder disputes, and (ii) diversification of risk. The distribution of the stock of Controlled is motivated in whole or in substantial part by one or both of these corporate business purposes.
- (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 any of Distributing or Controlled after the transaction.
- (h) There is no plan or intention by any of Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after

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the transaction other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

- (i) There is no plan or intention to liquidate any of Distributing or Controlled, to merge any of the corporations with any corporation, or to sell or otherwise dispose of the assets of any of the corporations after the transaction except in the ordinary course of business.
- (j) The total adjusted basis and fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject. The liabilities assumed 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.
- (k) Distributing neither accumulated its receivables nor made any extraordinary payment of its payables in anticipation of the transaction.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (m) Payments made in connection with all continuing transactions, if any, between any of 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 section 368(a)(2)(F)(ii) and (iv).
- (o) The distribution is not 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 50% or more of the total combined voting power of all classes of stock of any of Distributing or Controlled or stock possessing 50% or more of the total value of all classes of stock of any of Distributing or Controlled.
- (p) None of the distributions of the stock of Controlled will be a disqualified distribution within the meaning of section 355(d)(2).

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

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- (1) The transfer by Distributing to Controlled of a portion of the assets of Business A will be a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled each will be a “party to the reorganization” within the meaning of section 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of assets and related liabilities to Controlled in exchange for 100% of the stock of Controlled (sections 361(a) and 357(a)).
- (3) Controlled will recognize no gain or loss upon the receipt of assets and related liabilities of Distributing in exchange for shares of stock of such Controlled corporation (section 1032(a)).
- (4) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to its transfer to Controlled (section 362(b)).
- (5) The holding period of the Distributing assets received by Controlled will include the period during which such assets were held by Distributing (section 1223(2)).
- (6) Shareholder Group II will recognize no gain or loss upon the receipt of the shares of Controlled in exchange for all of its Distributing shares, as described above (section 355(a)(1)).
- (7) No gain or loss will be recognized by Distributing upon the distribution of stock of Controlled to Shareholder Group II, as described above (section 361(c)).
- (8) The basis of the stock of Controlled in the hands of Shareholder Group II will be the same as the basis of the Distributing stock surrendered by such shareholder in Shareholder Group II in exchange therefore (section 358(a)(1)).
- (9) The holding period of the stock of Controlled received by Shareholder Group II will include the holding period of the Distributing stock surrendered in the exchange therefore, 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), 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 Code and regulations or about the tax treatment of any

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conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not directly covered by the above rulings.

This ruling letter is directed only to the taxpayer 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 should 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.

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.

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

Sincerely,

Mark S. Jennings

Mark S. Jennings

Chief, Branch 1

Office of Associate Chief Counsel

(Corporate)

cc: