

INTERNAL REVENUE SERVICE

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December 3, 1998

Re:

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Retail Business =

Rental Business =

State A =

Court =

Custodian =

x =

Dear :

This is in response to a letter dated June 9, 1998, requesting a ruling as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated July 20, and November 24, 1998.

Distributing, a State A corporation that uses the accrual method and a calendar year, has for many years been engaged in two businesses: Retail Business and Rental Business. Distributing has outstanding a single class of voting common stock held 50% each by Shareholders A and B, who formerly were

husband and wife.

Controlled is a new corporation formed under the laws of State A. It will use the accrual method and a calendar year. Controlled will have outstanding solely voting common stock, all of which will initially be held by Distributing.

The financial information received indicates that the Retail Business and Rental Business of Distributing each have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past 5 years.

Shareholders A and B were divorced approximately a year ago. Marital discord, which existed for a considerable time prior to the divorce, resulted in management deadlock for Distributing and the eventual court appointment of an unrelated third party as Distributing's Custodian. In order to resolve the deadlock, the Court approved the Custodian's recommendation that Distributing be divided between Shareholders A and B. Shareholder A is to receive the Rental Business which is his area of expertise and the portion of the business historically managed by him. Shareholder B is to receive the Retail Business which is her area of expertise and the portion of the business historically managed by her. Accordingly, the following steps are proposed:

- (I) Distributing will transfer Rental Business assets and associated liabilities to Controlled in exchange for all the outstanding stock in Controlled. In addition, in order to equalize the values of Distributing and Controlled, Distributing will also transfer approximately x in cash and notes receivable to Controlled.
- (II) Thereafter, Shareholder A will exchange all of his stock in Distributing for all the outstanding stock in Controlled.

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

- (a) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing will each equal or exceed the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (b) The liabilities to be assumed by Controlled in the transfer, and the liabilities to which the transferred assets are subject, were incurred in the ordinary course of business and are associated with the assets

transferred.

- (c) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of this transaction.
- (d) None of the property transferred from Distributing to Controlled is property with regard to which any investment credit under § 46 of the Internal Revenue Code has or will be claimed or with regard to which any investment credit is required to be recaptured.
- (e) Neither Distributing nor Controlled has, or at the time of the transactions will have, any securities, warrants, or options outstanding.
- (f) The transaction will not constitute a disqualified distribution within the meaning of §355(d). None of the outstanding Distributing stock was acquired by either Shareholder A or B by purchase within the meaning of § 355(d)(5), and none of the stock in Distributing or Controlled will be "disqualified stock" within the meaning of § 355(d)(3).
- (g) Shareholder A will receive solely stock in Controlled in exchange for his stock in Distributing.
- (h) Distributing, Controlled, and the shareholders will each pay their own expenses incurred in connection with the transaction.
- (i) The fair market value of the stock of Controlled received by Shareholder A will approximately equal the fair market value of the Distributing stock surrendered by such shareholder in the exchange.
- (j) No part of the stock in Controlled received by Shareholder A is being received as a creditor, employee, or in any capacity other than as a shareholder of Distributing.
- (k) Following the proposed transaction, Distributing will continue, independently and with its separate employees, the active conduct of Retail Business which Distributing has actively conducted throughout the 5-year period immediately prior to the proposed stock distribution.
- (l) Following the proposed transaction, Controlled will continue, independently and with its separate

employees, the active conduct of Rental Business which will have been actively conducted by Distributing throughout the 5-year period immediately prior to step (II) above.

- (m) The 5 years of financial information submitted on behalf of Distributing for each of the two businesses is representative of each such business' present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (n) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, step (II).
- (o) It is not planned or intended for there to be any continuing transactions between Distributing and Controlled following step (II). If any transactions occur, payments made in connection with all continuing transactions 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.
- (p) The distribution of the stock of Controlled in step (II) is being carried out for the following corporate business purposes: (i) to comply with a court approved recommendation by the Custodian; and (ii) to eliminate shareholder deadlock and enable each business to be operated by the person most knowledgeable of the business.
- (q) There is no plan or intention to liquidate either Distributing or Controlled, to merge either Distributing or Controlled with any other corporation, or to sell or otherwise dispose of the assets of either Distributing or Controlled, subsequent to the transaction, except in the ordinary course of business.
- (r) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary, to purchase any of its outstanding stock after the transaction.
- (s) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, have redeemed, or otherwise dispose of any of their stock in Distributing or Controlled subsequent to the transaction.

- (t) There is no plan or intent for Shareholder B to lose control of Distributing (that is, to cease to hold over 50 percent of both (i) the total combined voting power and (ii) the total value of shares of all classes of stock in Distributing).
- (u) There is no plan or intent for Shareholder A to lose control of Controlled (that is, to cease to hold at least 50 percent of both (i) the total combined voting power and (ii) the total value of shares of all classes of stock in Controlled).
- (v) Neither Distributing nor Controlled is, plans, or intends to be an S corporation within the meaning of § 1361(a).
- (w) No two parties to the transaction (that is, Distributing and Controlled) are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

Based solely on the information submitted and on the representations set forth above, it is held as follows:

- (1) The transfer in step (I) by Distributing to Controlled of assets, as described above, followed by the distribution in step (II) by Distributing of all of the Controlled stock to Shareholder A is a reorganization within the meaning of §§ 368(a)(1)(D) and 355. Distributing and Controlled each will be a "party to a reorganization" within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing upon the transfer of assets, subject to liabilities, to Controlled in exchange for Controlled stock, as described above (§§ 361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled on the receipt of Distributing assets in exchange for Controlled stock (§ 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 the transfer (§ 362(b)).
- (5) The holding period of the assets received by Controlled will include the period during which such assets were held by Distributing (§ 1223(2)).
- (6) No gain or loss will be recognized by Distributing upon

the distribution to Shareholder A of all the Controlled stock (§ 361(c)(1)).

- (7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder A upon receipt of the Controlled stock (§ 355(a)(1)).
- (8) The basis of the Controlled stock in the hands of Shareholder A will, for each share, be the same as the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).
- (9) The holding period of the Controlled stock received by Shareholder A will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset by such shareholder on the date of the distribution (§ 1223(1)).
- (10) Proper allocation of earnings and profits will be made between Distributing and Controlled under § 1.312-10(a) of the regulations (§ 312(h)).

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

This ruling is directed only to the taxpayers who requested it. Section 6110(j)(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 letter is consummated.

Pursuant to the power of attorney on file in this matter, a copy of this letter is being sent to your authorized representatives.

Sincerely yours,

Assistant Chief Counsel (Corporate)

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By \_\_\_\_\_  
Howard W. Staiman  
Assistant Branch Chief, Branch 1