

Internal Revenue Service

Department of the Treasury

Index Numbers: 0368.06-00, 0355.01-00

Washington, DC 20224

Number: **199916014**
Release Date: 4/23/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:Corp:5-PLR-109740-98
Date:
01/13/1999

Distributing =

Controlled =

A =

B =

C =

D =

E =

Trust =

Business F =

Business G =

H =

J =

State X =

Dear

This is in reply to your letter dated April 15, 1998, requesting rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated October 2, November 18, December 3, December 16, and December 28, 1998. The information submitted for consideration is summarized below.

Distributing is an accrual basis State X corporation engaged in Business F and Business G directly and through controlled subsidiaries. A is Distributing's Chairman. A's son, D, serves as Chief Executive Officer of Distributing.

Following the death of A's wife, B, in 1979, and pursuant to a testamentary trust (the Trust) created by B's will, all of A's and B's Distributing shares were transferred to the Trust for the benefit of A and the lineal descendants of B. A and an independent third party are the trustees of the Trust. B's will directs that upon A's death, the Trust assets are to be divided into equal shares for the benefit of B's living children (currently, C and D). To achieve this goal, the will specifies that D's share will receive all of the Distributing stock held by the Trust and C's share will receive other assets equal in value to the Trust's Distributing stock. The shares will constitute separate trusts and the assets underlying each share will then be distributed to the appropriate beneficiary.

Distributing has issued and outstanding J shares of common stock, which are held in the following proportions:

<u>Shareholder</u>	<u>Percentage</u>
Trust	92
D	7
E (D's son)	1

Controlled was formed in State X on Date H to effectuate the proposed transaction. All of the outstanding Controlled stock is held by Distributing. Controlled will be an accrual basis corporation engaged in Business F and Business G.

Financial information has been submitted which indicates that each of Distributing's Business F and Business G has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Since 1994, C has investigated concerns of mismanagement of the Trust assets

by A and D. C also filed suit against A, D, and the co-trustee of the Trust, alleging that the defendants mismanaged the Trust assets, thereby reducing Distributing's value to the detriment of C.

The taxpayer has provided evidence showing that C's litigation has adversely affected Distributing's business operations. The taxpayer has also demonstrated that terminating the Trust at this time is not feasible. In settlement of the litigation, Distributing proposes the following transaction:

- (i) Trust will create two sub-trusts, the D sub-trust and the C sub-trust. C will appoint an independent trustee to administer the C sub-trust. The sub-trusts will operate independently of each other. Trust will transfer 57 percent of the Distributing stock to the D sub-trust and 35 percent to the C sub-trust. Upon A's death, the assets held by the C sub-trust are to be distributed to C, or her descendants, and the assets held by the D sub-trust are to be distributed to D, or his descendants.
- (ii) Distributing has transferred certain Business F and Business G assets, subject to related liabilities, to Controlled in exchange for Controlled stock. An investment credit determined under § 46 has not been, and will not be, claimed with respect to any property transferred by Distributing to Controlled.
- (iii) Distributing will distribute all of the Controlled stock to the C sub-trust in exchange for all of the C sub-trust's Distributing stock.

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

- (a) The fair market value of the controlled corporation stock and other consideration 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) The five years of financial information submitted on behalf of the controlled 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.
- (e) Following the transaction, the distributing and controlled corporations will each continue, independently and with its separate employees, the active conduct of its share of the integrated activities of the business conducted by the distributing corporation prior to consummation of the transaction.
- (f) The distribution of the stock of the controlled corporation is carried out for the following corporate business purpose: To resolve a dispute adversely affecting the business of the distributing corporation. The distribution of the stock of the controlled corporation is motivated, in whole or substantial part, by this corporate business purpose.
- (g) 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).
- (h) 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.
- (i) 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.
- (j) 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.
- (k) 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 plus any liabilities to which the transferred assets are subject.

- (l) 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.
- (m) The distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (n) 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.
- (o) 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 § 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; § 1.1502-13 as published by T.D. 8597). Further, the distributing corporation's excess loss account, if any, with respect to the controlled corporation stock will be included in income immediately before the distribution (See § 1.1502-19).
- (p) 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.
- (q) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (r) 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 percent or more of the total combined voting power of all classes of stock of either the distributing or controlled corporation, or stock possessing 50 percent or more of the total value of all classes of stock of either the distributing or controlled corporation.

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

- (1) The transfer by Distributing to Controlled of Business F and Business G assets described above, solely in exchange for stock of Controlled and the assumption of certain liabilities, followed by the distribution of the Controlled stock to the C sub-trust, as described above, will be a reorganization within the meaning of § 368(a)(1)(D) of the Code. Distributing and Controlled will each be "a party to a

reorganization" within the meaning of § 368(b).

- (2) No gain or loss will be recognized to 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 to Controlled on the receipt of Business F and Business G 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 each Business F and Business G asset received by Controlled from Distributing will include the period during which that asset was held by Distributing (§ 1223(2)).
- (6) No gain or loss will be recognized to the C sub-trust upon the exchange of Distributing stock for stock in Controlled (§ 355(a)(1)).
- (7) No gain or loss will be recognized to Distributing upon the distribution of all of the Controlled stock, as described above (§ 361(c)(1)).
- (8) The basis of the Controlled stock in the hands of the C sub-trust will, in each instance, 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 the C sub-trust will, in each instance, include the holding period of the Distributing stock surrendered in exchange therefor provided that such stock is held as a capital asset on the date of the exchange (§ 1223(1)).
- (10) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 1.312-10(a) of the Regulations.

No opinion is expressed concerning the federal income or estate tax consequences of any modification to the Trust or the transfer of assets to the C and D sub-trusts. In addition, no opinion is expressed concerning the federal income tax treatment of the proposed transactions under 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 transactions that are not specifically covered by the above rulings.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter (including regulations under § 358(g)) have not yet been adopted. Therefore, this ruling will be modified or revoked if adopted temporary or final regulations are inconsistent with any conclusions in the ruling. See, section 12.04 of Rev. Proc. 98-1, 1998-1 I.R.B. 7. However, when the criteria in section 12.05 of Rev. Proc. 98-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

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

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

Sincerely yours,
Assistant Chief Counsel (Corporate)

By: _____
Debra Carlisle
Chief, Branch 5