

Internal Revenue Service

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Person to Contact:

Telephone Number:

Refer Reply To:

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LEGEND

Distributing =

Controlled =

Business a =

State X =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Beneficiary =

Date 1 =

Date 2 =

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q shares =

r shares =

s shares =

t shares =

u shares =

v shares =

w shares =

x shares =

y shares =

z shares =

Dear :

This letter responds to a request for a private letter ruling dated July 17, 2002, submitted by you on behalf of Distributing with respect to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated September 6, 2002, and October 22, 2002. The rulings in this letter are based on the facts and representations submitted under penalties of perjury in support of the request. Verification of that information may be required as part of the audit process. The material information provided is summarized below.

Distributing is an accrual basis State X corporation which operates Business a and Business b. Distributing has outstanding q shares of voting common stock which are held by four shareholders, as follows:

<u>Shareholders</u>	<u>Common Stock Shares</u>
Shareholder A	u shares
Shareholder B	v shares
Shareholder C	r shares
Shareholder D	s shares

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Shareholder A and Shareholder B are brothers, and are the sons of Beneficiary. Shareholder C is a revocable grantor trust set up by Beneficiary. Shareholder D is a trust as to which Beneficiary is the lifetime beneficiary and Beneficiary's children are the remaindermen.

Financial information and supporting documentation has been received that indicates that each of Business a and Business b has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Shareholder A and Shareholder B are in charge of the operations of Distributing. Shareholder A is responsible for Business a and Shareholder B is responsible for Business b. For various reasons, Shareholder A and Shareholder B share a desire to operate Business a and Business b, respectively, apart from the influence of the other.

Accordingly, Distributing formed Controlled, a State X corporation, on Date 1 and transferred the assets associated with Business b to Controlled in exchange for t shares of Controlled common stock on Date 2. It is further proposed that Distributing will transfer all of the outstanding Controlled common stock to Shareholders B, C, and D solely in exchange for shares of their Distributing stock on a one-for-one basis. Ownership of the two corporations subsequent to the transaction shall be as follows:

<u>Shareholders</u>	<u>Distributing Shares</u>	<u>Controlled Shares</u>
Shareholder A	u shares	none
Shareholder B	none	v shares
Shareholder C	x shares	w shares
Shareholder D	y shares	z shares

Shareholder A will be the majority shareholder in Distributing and Shareholder B will be the majority shareholder in Controlled. It is represented that the Distributing stock held in trust by Shareholders C and D will be distributed to Shareholder A and that the Controlled stock so held will be distributed to Shareholder B, in due course.

Controlled and Distributing will file a consolidated return for the period beginning on Date 2 until the date of the distribution.

In connection with the proposed transaction, it has been represented that:

(a) Controlled will owe no indebtedness to Distributing after the distribution of the Controlled stock.

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(b) The fair market value of the Controlled stock to be received by each shareholder of Distributing who will receive Controlled stock will be approximately equal to the fair market value of the Distributing stock surrendered by that shareholder 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 of a shareholder of the corporation

(d) The 5 years of financial information submitted on behalf of Distributing for Business a and Business b is representative of the corporation's present operations, 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 the active conduct of its business, independently and with its separate employees.

(f) The distribution of the stock of Controlled is carried out for the following corporate business purposes: (i) to eliminate conflicts between the two shareholders who manage the separate businesses and, (ii) to allow the separate businesses to grow and become more profitable. The distribution of the stock, or stock and securities, of Controlled is motivated in whole or in substantial part, by these corporate business purposes.

(g) Distributing is not an S corporation, within the meaning of § 1361(a), and there is no plan or intention by Distributing or Controlled to make an S corporation election pursuant to § 1362(a).

(h) 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 either Distributing or Controlled after the transaction, except for those transfers through inheritance.

(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 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 after the transaction, except in the ordinary course of business.

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(k) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under Internal Revenue Code § 357(d)) by Controlled, plus any liabilities to which the transferred assets are subject.

(l) The liabilities assumed (as determined under Internal Revenue Code § 357(d)) 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) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.

(n) 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, Distributing's excess loss account with respect to the Controlled stock will be included in income immediately before the distribution (see § 1.1502-19).

(o) Payments made in connection with all continuing transactions, if any, 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) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(q) The distribution of Controlled stock is not part of a plan or series of related transactions (within the meaning of Internal Revenue Code § 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 entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

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

(1) The transfer by Distributing to Controlled of the assets associated with Business b in exchange for all the outstanding stock in Controlled, followed by the distribution of the Controlled stock to Shareholder B, Shareholder C, and Shareholder D, in exchange for Distributing stock, will be a reorganization within the meaning of § 368(a)(1)(D) of the Internal Revenue Code. Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).

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(2) No gain or loss will be recognized by Distributing on its contribution of the assets associated with Business b to Controlled in exchange for Controlled stock (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled on the receipt of the assets associated with Business b in exchange for Controlled stock (§ 1032(a)).

(4) The basis of the assets associated with Business b that Controlled received will be the same as the basis of those assets in the hands of Distributing immediately prior to the transfer (§ 362(b)).

(5) The holding period of the assets associated with Business b that Controlled received will include the respective periods during which such assets were held by Distributing (§ 1223(2)).

(6) No gain or loss will be recognized by (and no amount will be included in the income of) the stockholders of Distributing on the receipt of the Controlled stock (§ 355(a)).

(7) The basis of the Controlled stock received by Shareholder B, Shareholder C, and Shareholder D will be the same as the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

(8) The holding period of Controlled stock received by a stockholder of Distributing will include the holding period of the Distributing stock with respect to which it was distributed provided that such stockholder held the Distributing stock as a capital asset on the date of the distribution (§ 1223(1)).

(9) No gain or loss will be recognized by Distributing on the distribution to its stockholders of all of its Controlled stock (§ 361(c)).

(10) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Controlled and Distributing will be made under § 1.312-10(a) of the Income Tax Regulations.

(11) Pursuant to §§ 1245(b)(3) and 1250(d)(3), Distributing will not recognize any gain and will not include any amounts in income under §§ 1245(a) and 1250(a) on the transfer of Distributing's assets to Controlled.

No opinion is expressed about the tax consequences of the 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.

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

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

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

Sincerely yours,

Debra Carlisle

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