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Person To Contact:

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Date:

November 20, 2003

LEGEND

Distributing =

Sub =

Controlled =

Trust =

A =

B =

C =

D =

E =

PLR-145936-03

F =

G =

H =

I =

Business X =

Business Y =

a =b =c =d =\$e =\$f =x% =y% =

Dear

This letter responds to your letter, dated July 28, 2003, requesting rulings under I.R.C. §§ 368 and 355. Additional information was submitted in a letter dated November 6, 2003. The information submitted in your letters is summarized below.

Distributing is a corporation engaged in Business X and is the common parent of an affiliated group of corporations filing consolidated federal income tax returns. Distributing owns all of the stock of Sub and Controlled. Controlled is engaged in Business Y.

PLR-145936-03

Distributing has outstanding d shares of common stock. Two families each own 50% of its stock, c shares. The stock owned by one family is held by Trust. A and B are husband and wife and the trustees of Trust. C and D are successor trustees and the children of A or B. The other family's stock is owned as follows: E owns b shares, y%. F, G, H, and I each own a shares, x%. F, G, H, and I are the children of E and his wife.

Currently, Distributing is indebted to Trust, or to related parties (but not Controlled), in the amount, collectively, of \$e. Controlled is indebted to Distributing in the amount of \$f.

The taxpayer has supplied financial information that indicates that each of Business X and Business Y had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

The two families have divergent views as to the current operations and future direction of Business X and Business Y, which have adversely affected the business operations of Distributing and Controlled. To address this problem and to allow each family to concentrate on the business that that family is interested in, the parties have devised the following plan:

- 1) In order to equalize the values of Business X and Business Y: (a) Sub will distribute certain specified properties used in Business Y to Distributing, (b) Distributing will contribute those properties, as well as other specified property used in Business Y and cash, to Controlled, and (c) Controlled will use a portion of the cash received to satisfy its debt to Distributing.
- 2) Distributing will distribute all of the Controlled stock to Trust in exchange for all of Trust's Distributing stock.
- 3) Distributing will repay the debt it owes to Trust, and related parties, within a five-year period starting on the date of the Distribution. Distributing has represented that this debt cannot be repaid as part of the Distribution because Distributing does not currently have sufficient funds, and is limited in its ability to obtain financing to retire the debt in connection with the Distribution.
- 4) Sometime following the Distribution, the remaining shareholders of Distributing, who are all members of one family, intend to transfer their Distributing stock to a newly created family trust (the "Family Transfer"). Each shareholder will have a beneficial interest in this trust that is the same as their interest in their Distributing stock. Thus, following the Distribution and the Family Transfer, the trust will own all of the Distributing stock.
- 5) After the Distribution, Trust may gift nominal amounts of Controlled stock to some or all of the children of A and B (the "Gift Transfers").

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

PLR-145936-03

- (a) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled (as determined under section 357(d)).
- (b) The liabilities assumed by Controlled in the transaction (as determined under section 357(d)) were incurred in the ordinary course of business and are associated with the assets being transferred.
- (c) No investment credit determined under section 46 has been (or will be) claimed with respect to any property transferred between Distributing and Controlled.
- (d) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the Distribution.
- (e) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, except for any indebtedness incurred in the ordinary course of business or for obligations resulting from arm's-length agreements for shared services or facilities for a brief transitional period.
- (f) 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 section 1.1502-13 and section 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; section 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account, if any, with respect to the Controlled stock will be included in income immediately before the Distribution (see section 1.1502-19).
- (g) Payments made in connection with 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.
- (h) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (i) No part of the consideration to be distributed by Distributing will be received by a shareholder of Distributing as a creditor, employee or in any capacity other than that of a shareholder of Distributing.
- (j) The fair market value of Controlled stock and other consideration to be received by Trust will be approximately equal to the fair market value of the Distributing stock surrendered by Trust in the exchange.
- (k) The five years of financial information submitted on behalf of Distributing is representative of its present operations, and with regard to such corporation,

PLR-145936-03

there have been no substantial operational changes since the date of the last financial statements submitted.

- (l) The five years of financial information submitted by Distributing on behalf of Controlled is representative of its present operations of Business Y, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (m) The gross assets of Business X to be conducted by Distributing immediately after the Distribution will have a fair market value that is greater than five percent of the total fair market value of Distributing's gross assets at that time.
- (n) The gross assets of Business Y to be conducted by Controlled immediately after the Distribution will have a fair market value that is greater than five percent of the total fair market value of Distributing's gross assets at that time.
- (o) Following the Distribution, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of Business X and Business Y, respectively, conducted by Distributing and Controlled prior to the consummation of the transaction.
- (p) The Distribution of Controlled is primarily carried out for the following corporate business purpose: to resolve management, systemic and other problems that arise because of shareholder conflicts over the future direction of Business X and Business Y and to enable each group of shareholders to focus on a particular business. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (q) Except for the Family Transfer and Gift Transfers described above, there is no plan or intention by any shareholder to sell, exchange, transfer by gift or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the Distribution.
- (r) 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 Distribution, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (s) 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 Distribution, except in the ordinary course of business.
- (t) For purposes of section 355(d), immediately after the Distribution, no person or persons (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of

PLR-145936-03

Distributing stock entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

- (u) For purposes of section 355(d), immediately after the Distribution, no person or persons (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled stock that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (v) The Distribution is not a 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 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.
- (w) Distributing is not an S corporation (within the meaning of section 1361(a)), and there is no plan or intention by Distributing or Controlled to make an S corporation election pursuant to section 1362(a).

Based solely on the information submitted and the representations made, we rule as follows:

- 1 The contribution by Distributing of certain specified properties (including properties received from Sub), plus cash, to Controlled in constructive exchange for additional Controlled voting common stock and the assumption by Controlled of the associated liabilities, followed by the non-pro rata distribution by Distributing of all of the Controlled stock to Trust in exchange for all of Trust's Distributing stock, will constitute a reorganization within the meaning of section 368(a)(1)(D) of the Internal Revenue Code. Distributing and Controlled will each be a "party to the reorganization" within the meaning of section 368(b).
- 2 No gain or loss will be recognized by Distributing upon its constructive receipt of additional Controlled stock in exchange for the transfer of assets to, and the assumption of liabilities by, Controlled. Section 361(a) and (b)(1) and section 357(a).

- 3 No gain or loss will be recognized by Controlled upon its receipt of assets in exchange for its constructive issuance of additional shares of Controlled stock. Section 1032(a).
- 4 Controlled's basis in the assets received from Distributing will equal the basis of such assets in the hands of Distributing immediately prior to the transfer. Section 362(b).
- 5 The holding period of each asset received by Controlled from Distributing will include the period during which Distributing held such asset. Section 1223(2).
- 6 Distributing will not recognize gain or loss upon the Distribution of the stock in Controlled to Trust. Section 361(c)(1).
- 7 No gain or loss will be recognized to (and no amounts will be included in the income of) Trust upon its receipt of Controlled stock. Section 355(a)(1).
- 8 The basis of the Controlled stock in the hands of Trust will be the same as the basis of the Distributing stock surrendered in exchange therefor. Section 358(a)(1).
- 9 The holding period of the Controlled stock received by Trust 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 day of the Distribution. Section 1223(1).
- 10 Proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with section 312(h), Treas. Reg. § 1.312-10(a) and Treas. Reg. § 1.1502-33(e)(3).

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

This ruling 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 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 taxpayer.

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.

Sincerely,

Reginald Mombrun

Reginald Mombrun
Assistant Branch Chief, Branch 6
Office of Associate Chief Counsel
(Corporate)

PLR-145936-03

9

cc: