

Internal Revenue Service

Department of the Treasury

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August 18, 1999

Distributing =

Controlled =

Year =

Family =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Shareholder F =

Shareholder G =

Shareholder H =

Shareholder I =

Business A =

Business B =

Business C =

Business D =

j =

k =

l =

m =

n =

p =

q =

r =

s =

t =

w =

v =

x =

\$aa =

We respond to your letter dated April 2, 1999, in which rulings are requested regarding the federal income tax consequences of a proposed transaction. The information submitted is summarized below.

Distributing is the common parent of a group of corporations filing consolidated returns. Distributing was incorporated in Year primarily to consolidate the various business activities of the Family. Distributing, thus, currently is engaged, directly and through its various subsidiaries, in Business B, Business C, and Business D. One subsidiary, Controlled, is engaged in Business A.

The shareholders of Distributing currently hold their stock as follows:

	Common Stock	Class A Preferred	Class B Preferred
Shareholder A	0	<u>k</u>	0
Shareholder B	<u>j</u>	<u>l</u>	0
Shareholder C	0	0	<u>q</u>
Shareholder D	<u>i</u>	<u>m</u>	0
Shareholder E	<u>j</u>	<u>m</u>	0
Shareholder F	0	<u>n</u>	0
Shareholder G	0	<u>n</u>	0
Shareholder H	0	<u>p</u>	0
Shareholder I	0	<u>p</u>	0
Distributing ESOP	0	0	0

Distributing and the Family propose to undertake a combination of sales and exchanges in order to resolve shareholder disputes regarding the proper management of the businesses of Distributing.

In particular, Distributing and the Family propose to take the following steps:

- (i) The Distributing ESOP will purchase x shares of the Distributing common stock held by each of Shareholder D and Shareholder E.
- (ii) Shareholder B will purchase all of the Class A Preferred Distributing stock held by each of Shareholder D, Shareholder E, Shareholder F, and Shareholder G.

- (iii) Shareholder A will exchange all of his Class A Preferred Distributing stock for Controlled stock.
- (iv) Shareholder C will exchange all of her Class B Preferred Distributing stock for Controlled stock.
- (v) Shareholder D and Shareholder E each will exchange his remaining shares of Distributing common stock for Controlled stock and a promissory note in the principal amount of \$ aa.

Following the completion of the sales and the exchanges described above, the present and former shareholders of Distributing will hold shares of Distributing and Controlled as follows:

	Controlled Common Stock	Distributing Common Stock	Distributing Class A	Distributing Class B
Shareholder A	<u>r</u>	0	0	0
Shareholder B	0	<u>u</u>	0	0
Shareholder C	<u>s</u>	0	0	0
Shareholder D	<u>t</u>	0	0	0
Shareholder E	<u>t</u>	0	0	0
Shareholder F	0	0	0	0
Shareholder G	0	0	0	0
Shareholder H	0	0	<u>p</u>	0
Shareholder I	0	0	<u>p</u>	0
Distributing ESOP	0	<u>v</u>	0	0

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) Indebtedness owed by Controlled to Distributing, if any, after the distribution will not constitute stock or securities.
- (b) The stock of Controlled will be distributed to Distributing Shareholder A, Shareholder C, Shareholder D, and Shareholder E on a non pro rata basis, according to the fair market value of the shares based on appraised value. The fair market value of the Controlled stock to be received by Shareholder A, Shareholder C, Shareholder D, and Shareholder E of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by those 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 of a shareholder.
- (d) The five years of financial information submitted on behalf of Distributing and its subsidiaries, including Controlled, is representative of each corporation's present operations, and, with regard to each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
 - (e) Immediately after the distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
 - (f) Following the transaction, Distributing and Controlled each will continue the active conduct of its business, independently and with its separate employees.
 - (g) The distribution of the Controlled stock is carried out for the following corporate business purposes: to resolve various issues relating to day-to-day management and long term objectives, as well as problems arising from shareholder disputes, differences of opinion as to strategic goals, and the problems of operating Business A in conjunction with the other different businesses within the same affiliated group. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
 - (h) Shareholder B will purchase, at the appraised value, all of the Preferred Class A stock owned by each of Shareholder D, Shareholder E, Shareholder F, and Shareholder G. Otherwise, there is no plan or intention by any shareholder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the transaction.
 - (i) The Distributing ESOP will purchase a portion of each of Shareholder D's and Shareholder E's Distributing common stock in conjunction with the transaction. Otherwise, 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 section 4.05(1)(b) of Revenue Procedure 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.

- (k) No intercorporate debt will exist between Distributing and Controlled at the time of or subsequent to the proposed distribution.
- (l) 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 will not have an excess loss account with respect to the Controlled stock immediately before the distribution (See § 1.1502-19).
- (m) Payments made in connection with all continuing transactions between Distributing and Controlled, if any, 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 § 368(a)(2)(F)(iii) and (iv).
- (o) The distribution of Controlled stock is not part of a "plan or series of related transactions" 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.
- (p) Neither Distributing or Controlled is an S corporation within the meaning of § 1361(a), and there is no plan or intention by either Distributing or Controlled to make an S corporation election pursuant to § 1362(a).

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

- (1) No gain or loss will be recognized to Distributing upon the distribution of Controlled stock to Shareholder A and Shareholder C, and Controlled stock and promissory notes to Shareholder D and Shareholder E, in exchange for their Distributing stock (§ 355(c)).
- (2) No gain or loss will be recognized to (and no amount will be included in the income of) Shareholder A and Shareholder C upon their receipt of the stock of Controlled from Distributing in exchange for all of their stock in Distributing (§ 355(a)(1)).
- (3) Shareholder D and Shareholder E each will recognize gain (if any), but not loss, on his receipt of Controlled stock and a promissory note in exchange

for all of his Distributing common stock, but not in excess of the fair market value of the promissory note received (§ 356(a)(1); Rev. Rul. 93-62, 1993-2 C.B. 118).

- (4) The holding period of the Controlled stock received by Shareholder A, Shareholder C, Shareholder D, and Shareholder E will include each shareholder's holding period of their Distributing stock exchanged therefor, provided that such Distributing stock is held as a capital asset on the date of the transaction (§ 1223(1)).
- (5) The basis of the Controlled stock in the hands of Shareholder A and Shareholder C received in the transaction will be the same as the basis of the Distributing stock surrendered by each in exchange therefor immediately before the transaction (§ 358(a)(1)).
- (6) Shareholder D's and Shareholder E's basis in the stock of Controlled after the exchange will equal the basis of the Distributing stock surrendered by each, decreased by the fair market value of the promissory note received by each and increased by the amount of gain that each recognized on the exchange (§ 358(a)(1)).
- (7) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(b).

We express no opinion on the tax treatment of Shareholder B's purchase of all of the Class A Preferred Distributing stock held by each of Shareholder D, Shareholder E, Shareholder F, and Shareholder G. We express no opinion regarding whether the Distributing ESOP's purchase of x shares of the Distributing common stock held by each of Shareholder D and Shareholder E will be treated as a sale or exchange under § 1001, a distribution of a dividend under § 301, or a redemption of stock under § 302; and whether Shareholder D's and Shareholder E's exchange of part of their Distributing common stock for promissory notes will have the effect of a distribution of a dividend within the meaning of § 356(a)(2) or a distribution in redemption of stock under § 302(a). Furthermore, we express no opinion about the tax treatment 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.

This ruling is directed only to the taxpayer who requested 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.

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: *Filiz A. Serbes*

Filiz A. Serbes

Assistant to Chief, Branch 5