

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Date:

May 06, 2004

LEGEND

Distributing =

Controlled =

A =

B =

C =

D =

E =

F =

G =

H =

Court =

Agreement =

Property =  
State X =  
Date1 =  
Date2 =  
a =  
b =  
c =  
d =  
e =  
f =  
g =  
h =

Dear :

This letter responds to your [October 24, 2003](#) request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in this request and in subsequent correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This Office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the proposed transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)), and (iii) is part of a plan (or series of related

transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e)(2)(A)(ii) and § 1.355-7T).

Distributing is a State X corporation incorporated on Date1 (more than 5 years ago). Distributing utilizes the cash method of accounting and a taxable year ending on Date2 in filing its federal income tax return. Distributing has only one class of common stock issued and outstanding. All of Distributing's common stock is held by individual shareholders A, B, C, D, E, F, and G in the respective amounts of a%, b%, c%, d%, e%, f%, and g%.

Distributing is engaged in the H business. Financial information has been submitted indicating that the H business has gross receipts and operating expenses representing the active conduct of a trade or business for each of the past 5 years.

For what are represented to be valid business purposes, the following transaction has been proposed:

- (i) Distributing will contribute to a newly incorporated Controlled h% of Distributing's Property in exchange for all of the Controlled stock. No liabilities will be assumed nor will any of the Property transferred be subject to any liabilities.
- (ii) Distributing will distribute all of the Controlled stock to shareholders A and B in exchange for all of their Distributing stock.

Controlled will be incorporated as a State X corporation. Controlled will also be a cash method basis taxpayer and have a taxable year ending Date2. All of the stock of Controlled will be held by Distributing immediately prior to the distribution of the stock of Controlled. After the distribution of Controlled stock, neither Distributing nor shareholders C through G will hold any Controlled stock.

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

- (a) The fair market value of the Controlled stock to be received by each shareholder of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.
- (b) 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.
- (c) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, of and with regard to

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

- (d) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all of the integrated activities of the business conducted by Distributing prior to the consummation of the transaction.
- (e) The distribution of the stock of Controlled is carried out for the following business purposes: (i) to resolve shareholder and director deadlocks; (ii) to settle litigation seeking to dissolve Distributing; and (iii) to allow the historic H operations to continue by the shareholder factions in an unfettered way and without interference from the other. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (g) Immediately after the distribution, no person will hold, directly or indirectly, disqualified stock (within the meaning of §355(d)(3)) in Distributing or Controlled that constitutes a 50 percent or greater interest (within the meaning of §355(d)(4)) in Distributing or Controlled.
- (h) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (i) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (j) 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.
- (k) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (l) There is no acquisition of stock of Distributing or Controlled (including any predecessor or successor of any such corporation) that is part of a plan or series of related transactions (within the meaning of § 1.355-7T) that includes the distribution of the Controlled stock.

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

- (1) The transfer by Distributing of assets in exchange for Controlled stock followed by the distribution of Controlled stock to shareholders A and B, will be a reorganization within the meaning of § 368(a)(1)(D) of the Code. 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 on the transfer of assets to Controlled in exchange for Controlled stock (§ 361(a)).
- (3) No gain or loss will be recognized by Controlled on the receipt of assets from Distributing in exchange for Controlled stock (§ 1032(a)).
- (4) Controlled's basis in the Distributing assets received by Controlled in the transaction will be the same as the basis of such assets in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (5) Controlled's holding period of the Distributing assets received by Controlled in the transaction 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 its shareholders of the stock of Controlled in exchange for Distributing stock held by such shareholders (§ 361(c)).
- (7) No gain or loss will be recognized by (and no amount will be includible in the income of) the shareholders of Distributing on the receipt of stock of Controlled in exchange for Distributing stock (§ 355(a)(1)).
- (8) The basis of the Controlled stock held by shareholders A and B immediately after the distribution of Controlled stock will, in each instance, equal the basis of such shareholder's Distributing stock held immediately before the distribution of Controlled stock (§ 358(a)(1)).
- (9) The holding period of the Controlled stock received by shareholders A and B will include the holding period of the Distributing stock surrendered in exchange therefor, provided the Distributing stock is held as a capital asset by such shareholders on the date of the exchange (§ 1223(1)).
- (10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under Treas. Reg. § 1.312-10(a).

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

regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the proposed transaction is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii).

This ruling is directed only to the taxpayer(s) 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 authorized representative.

Sincerely,

*Debra L. Carlisle*

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Debra L. Carlisle  
Branch Chief  
Office of Associate Chief Counsel  
(Corporate)

cc: