

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:B05 - PLR-101047-01
Date:
January 17, 2001

Re:

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Individual: =

Business A =

Business B =

State X =

Date R =

p =

q =

r =

s =

t =

u =

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This is in reply to a letter dated November 15, 1999, in which a ruling is requested as to the federal income tax consequences of a transaction consummated on Date R. Additional information was submitted in letters dated February 25, March 8, March 24, June 1 and July 12, 2000. The facts submitted for consideration are substantially as set forth below. This letter replaces our letter dated September 6, 2000.

Distributing is a State X corporation which is engaged in Business A. Prior to Date R, Distributing had outstanding p shares of Class A Common Stock and q shares of Class B Common Stock. Prior to Date R, Distributing's stock was held by or for the benefit of descendants of Individual (now deceased) consisting of Individual's six children and their children.

Controlled is a State X corporation which is engaged in Business B. Controlled has outstanding solely common stock, all of which was held by Distributing.

Sub 1 is a State X corporation which is wholly owned by Distributing.

Financial information has been submitted which indicates that each of Distributing and Controlled had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the last five years.

In the course of the past several years irreconcilable differences arose between the Distributing shareholders over the operation and future of Distributing, and in particular the relative emphases to be placed upon Business A and Business B. Certain shareholders ("the Remaining Shareholders") desired that the company emphasize Business A and de-emphasize Business B. Other shareholders ("the Settling Shareholders") desired that Distributing increase emphasis on Business B and de-emphasize Business A. These differences significantly impaired operations of the corporation. To alleviate these operating difficulties, the following transaction was consummated:

- (i) In partial payment of accrued interest payable on a previously outstanding debt by Controlled to Distributing, Controlled issued to Distributing a five year promissory note ("the Controlled Note").
- (ii) Distributing contributed to the capital of Controlled the remainder of all the intercompany payables, notes payable, accrued interest and all other amounts owed by Controlled to Distributing.
- (iii) Distributing transferred to Controlled as a capital contribution assets of Business B. In addition, Sub 1 transferred to Controlled all the assets of Business B that were owned by Sub 1 and all of the intercompany

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payables and all other amounts that were owed by Controlled to Sub 1.

- (iv) Controlled paid a cash dividend to Distributing in an amount less than \$ r pursuant to the reorganization plan.
- (v) Controlled assumed certain employment contracts between Distributing and certain executives who worked in Business B. Distributing paid a cash contribution to Controlled to assist Controlled in performing the severance and other obligations under those contracts.
- (vi) Distributing distributed to the Settling Shareholders all the Controlled stock, cash of \$ r (the "Cash Payment") and a \$ s Distributing promissory note (the "Distributing Note") in exchange for all of the Settling Shareholders' shares of Distributing stock (Class A and Class B) which was t shares. The Distributing Note is due and payable in full on the fifth anniversary of the date on which Distributing distributed the Controlled stock.
- (vii) Controlled amended its certificate of incorporation to increase its authorized shares of Controlled common stock and engaged in a stock split.

After the distribution, three of the Controlled shareholders sold all of their Controlled stock, amounting to u percent of the outstanding stock of Controlled, to Controlled.

In connection with the transaction, the following representations have been made:

- (a) The fair market value of Controlled stock and the other consideration received by the Settling Shareholders equaled the fair market value of the Distributing stock surrendered in the exchange.
- (b) No part of the consideration distributed by Distributing was received by any Settling Shareholders as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The indebtedness owed by Controlled to Distributing after the distribution of Controlled stock does not constitute stock or securities.
- (d) The five years of financial information submitted on behalf of Distributing and Controlled is representative of the present operations of each, and there have been no substantial operational changes since the date of the last financial statements submitted.

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- (e) Following the distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees
- (f) The transaction was carried out to end shareholder disputes over the operation of Business A and Business B. The transaction was motivated, in whole or substantial part, by this corporate business purpose.
- (g) Other than the redemption of the Settling Shareholders' stock (described in Step (vi) above) and the redemption of the three Controlled shareholders, as described above, there is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in Distributing or Controlled after the distribution.
- (h) Other than the redemption of the three Controlled shareholders, as described above, 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.
- (i) 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.
- (j) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under §357(d)) by Controlled.
- (k) The liabilities assumed (as determined under §357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.
- (l) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv) of the Internal Revenue Code.
- (m) Payments made in 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.
- (n) Immediately before the transaction, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Further, Distributing's

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excess loss account, if any, with respect to the Controlled stock will be included in income immediately before the transaction.

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

- (1) For federal income tax purposes, the transfer by Sub 1 to Controlled described in step (iii) shall be viewed as a transfer in exchange for an amount of Controlled stock equal in value to that of the assets transferred by Sub 1, followed by a distribution of the constructively received Controlled stock to Distributing. No gain or loss will be recognized to Sub 1 on the transfer of assets, subject to liabilities, to Controlled (§§351(a) and 357(a)).
- (2) The transfer by Distributing to Controlled of assets, subject to liabilities, as described above in steps (ii), (iii), and (v), and the cash distribution set forth in step (iv), shall be viewed, for federal income tax purposes, as a transfer in exchange for Controlled stock equal in value to that of the assets transferred by Distributing minus the amount of the cash distributed by Controlled, followed by the distribution of the Controlled stock, the cash payment, and the Distributing Note to the Settling Shareholders in exchange for all of their stock of Distributing. The transaction 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).
- (3) No gain or loss will be recognized to Distributing upon the transfer of assets to Controlled in exchange for Controlled stock, cash, and the assumption of liabilities, as described above (§361(a) and §357(a)).
- (4) The basis of the assets received by Controlled from Distributing (or Sub 1) will be the same as the basis of such assets in the hands of Distributing (or Sub 1) immediately prior to the transaction (§362(a) and (b)).
- (5) The holding period of Distributing’s (or Sub 1’s) assets received by Controlled will include the period during which such assets were held by Distributing or (Sub 1) (§1223(2)).
- (6) No gain or loss will be recognized to Controlled on receipt of the assets from Distributing and Sub 1, as described in steps (ii), (iii), and (v), solely in exchange for Controlled stock (§1032(a)).
- (7) Gain but not loss will be recognized to the Settling Shareholders upon the receipt of the Controlled stock, the Distributing Note, and cash in exchange for the stock of Distributing held by the Settling Shareholders in an amount not in excess of the sum of such cash and the value of the

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Distributing Note (§356(a)(1)). The gain shall be treated as gain from the exchange of property (§356(a)(2) and Rev. Rul. 93-62, 1993-2 C.B. 118).

- (8) No gain or loss will be recognized to Distributing upon the distribution of all of the Controlled stock, the Cash Payment, and the Distributing Note (§361(c)(1)).
- (9) The basis of the Controlled stock in the hands of the Settling Shareholders will be the same as the basis of the Distributing stock surrendered in exchange therefor decreased by the Cash Payment and the fair market value of the Distributing Note, and increased by the amount of any gain recognized by the Settling Shareholders (§358(a)(1)).
- (10) The holding period of the Controlled stock 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 date of the exchange (§ 1223(1)).
- (11) 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.
- (12) Controlled will be subject to the applicable built-in gain tax of §1374 with respect to any net recognized built-in gain attributable to the assets it receives from Distributing and Sub 1.
- (13) To the extent that (1) a Settling Shareholder's interest in, or share of, the Distributing Note received in exchange for the Settling Shareholder's Distributing stock is properly characterized solely as consideration for the Distributing stock transferred to Distributing; (2) each Settling Shareholder who receives an interest in, or share of, the Distributing note is not otherwise prohibited from use of the installment method; and (3) the Settling Shareholder's exchange of Distributing stock for an interest in, or share of, the Distributing Note results in the realization of a gain by the Settling Shareholder, each such Settling Shareholder who does not elect out of the installment method will be required to report the income realized from the exchange of Distributing stock for an interest in, or share of, the Distributing Note on the installment method.

The information provided in the request for ruling does not provide an adequate basis for a determination whether any Settling Shareholder would be a related person, within the meaning of §453(f)(1), to any Distributing shareholder after the completion of the transactions described in the request for ruling. If a Settling Shareholder and a Distributing Shareholder would be related persons within the meaning of §453(f)(1), the provision of §453B, including §453B(f) would apply.

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No opinion is expressed 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) 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.

Pursuant to a power of attorney on file in this office, we have sent a copy of this letter to the taxpayer and an authorized representative.

Sincerely yours,
Associate Chief Counsel (Corporate)

By: Debra Carlisle

Chief, Branch 5

cc: