

Internal Revenue Service

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Distributing =

Controlled 1 =

Controlled 2 =

Shareholders A =

Shareholders B =

Shareholders C =

business a =

Dear _____ :

This is in response to a letter dated March 30, 1999, in which rulings are requested regarding the federal income tax consequences of a proposed transaction. Additional information was received in letters dated June 23, July 28, and August 19, 1999. The information submitted is summarized below.

Distributing is a closely held family business engaged in business a. The Distributing shares are presently held in the following proportions:

Shareholders A	32.764%
Shareholders B	33.202%
Shareholders C	34.034%

In order to resolve irreconcilable shareholder disagreements over the management of business a, a separation of the business is proposed. Distributing has formed Controlled 1 and Controlled 2 with approximately one third of its operating assets in each subsidiary. A non pro rata distribution of Controlled 1 and Controlled 2 is proposed so that after the distribution, the Shares of Distributing, Controlled 1 and Controlled 2 will be held as follows:

100% of Distributing	100% of Controlled 1	100% of Controlled 2
Shareholders B	Shareholders C	Shareholders A

Distributing has no non-recourse liabilities. In connection with the transaction proposed, all of Distributing's recourse liabilities will be refinanced, and some of the refinanced liabilities will be assumed by either Controlled 1 or Controlled 2. Each liability assumed will be assumed only by one corporation. No liability assumed by either Controlled 1 or Controlled 2 will also be assumed by any other person. The liabilities being assumed by Controlled 1 exceed the adjusted basis of the assets being transferred to Controlled 1.

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

- (a) The fair market value of the Controlled 1 and Controlled 2 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) The five years of financial information submitted on behalf of Distributing is representative of that corporation's present operation, and, with regard to such

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

- (c) Following the transaction, Distributing, Controlled 1 and Controlled 2 will each continue the active conduct of its business, independently and with its separate employees.
- (d) The distribution of the stock of Controlled 1 and Controlled 2 is carried out for the following corporate business purposes: to resolve irreconcilable differences between the shareholders over the management of business a. The distribution of stock of Controlled 1 and Controlled 2 is motivated, in whole or substantial part, by this corporate business purpose.
- (e) 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, Controlled 1 or Controlled 2 after the transaction except there will be a continuing program of annual gift giving to certain minor shareholders by their shareholder parents.
- (f) There is no plan or intention by either Distributing, Controlled 1 or Controlled 2, 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.
- (g) There is no plan or intention to liquidate either Distributing, Controlled 1 or Controlled 2, 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.
- (h) No intercorporate debt will exist between Distributing and Controlled 1 or Controlled 2 at the time of, or subsequent to, the distribution of the Controlled 1 and Controlled 2 stock.
- (i) The total adjusted bases and the fair market value of the assets transferred to Controlled 2 by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled 2, and the liabilities assumed 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.
- (j) The fair market value but not the total adjusted basis, of the assets transferred to Controlled 1 by Distributing, will equal or exceed the sum of the liabilities to be assumed by Controlled 1.

- (k) Distributing neither accumulated its receivables nor made extraordinary payment of its payable in anticipation of the transaction.
- (l) The income tax liability for the taxable year in which investment credit property (including any building to which section 47(d) applies) is transferred will be adjusted pursuant to section 50(a)(1) or (a)(2)(or section 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990)), if applicable) to reflect an early disposition of the property.
- (m) Payments made in connection with all continuing transactions between Distributing, Controlled 1 and Controlled 2, 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 section 368(a)(2)(F)(iii)and (iv).
- (o) The distribution of Controlled 1 and Controlled 2 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, Controlled 1 or Controlled 2.
- (p) Neither Distributing, Controlled 1 or Controlled 2 is an S corporation within the meaning of Code section 1361(a), and there is no plan or intention by either Distributing or Controlled to make an S corporation election pursuant to Code section 1362(a).

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

- (1) The transfer by Distributing to Controlled 1 and Controlled 2 of the assets associated with business a solely in exchange for all of the outstanding Controlled 1 and Controlled 2 stock, and the assumption of liabilities, followed by the distribution of all the Controlled 1 and Controlled 2 stock to Distributing's shareholders in exchange for their stock in Distributing, as described above, will be a reorganization within the meaning of section 368(a)(1)(D). Distributing, Controlled 1 and Controlled 2 will each be "a party to a reorganization" within the meaning of section 368(b).
- (2) Distributing will recognize no gain or loss upon its transfer of assets to Controlled 2 in exchange for Controlled 2 stock and the assumption by Controlled 2 of Distributing's liabilities as described above (§§ 361(a) and 357(a)).

- (3) Gain will be recognized to Distributing to the extent that the liabilities to be assumed by Controlled 1 within the meaning of section 357(d)(1)(A) exceed Distributing's adjusted bases in the assets transferred to Controlled 1 (§ 357(c)). No loss will be recognized to Distributing in the transaction (§ 361(a)).
- (4) Controlled 1 and Controlled 2 will recognize no gain or loss on the receipt of the assets of Distributing in exchange for Controlled 1 or Controlled 2 stock (§ 1032).
- (5) Controlled 2's basis of the assets received will be the same as the basis of such assets in the hands of Distributing immediately prior to the exchange (§ 362(b)).
- (6) Controlled 1's basis of the assets received will be the same as the basis of such assets in the hands of Distributing immediately prior to the exchange plus the amount of gain recognized under ruling (3) above, but in no event shall the basis of any property be increased above its fair market value (§ 362(b) and (d)).
- (7) Controlled 1's and Controlled 2's holding period for the assets received will, in each case, include the period during which such assets were held by Distributing (§ 1223(2)).
- (8) No gain or loss will be recognized to (and no amount will be included in the income of) the shareholders of Distributing upon their receipt of the stock of Controlled 1 or Controlled 2 from Distributing (§ 355(a)(1)).
- (9) The holding period of the Controlled 1 and Controlled 2 stock received by the shareholders of Distributing will include the holding period of their Distributing stock with respect to which the distribution is made, provided that such Distributing stock is held as a capital asset on the date of the distribution (§ 1223(1)).
- (10) As provided in section 312(h), proper allocation of earnings and profits between Distributing, Controlled 1 and Controlled 2 will be made under section 1.312-10(a).
- (11) No gain or loss will be recognized to Distributing upon the distribution of its stock in Controlled 1 or Controlled 2 to its shareholders (§ 361(c)(1)).
- (12) The basis of the Controlled 1 and Controlled 2 stock in the hands of Shareholders A and Shareholders C after the distribution, in each instance, will be the same as the basis of the Distributing stock surrendered by each in exchange therefor (§ 358(a)(1)).

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(j)(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 Debra Carlisle

Debra Carlisle
Chief, Branch 5