

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

October 20, 2000

**LEGEND:**

Distributing =

Controlled =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Business A =

Business B =

Business C =

Business D =

Business E =

State X =

a =

b =

c =

Year 1 =

Dear:

This letter responds to your Authorized Representatives' letter dated March 29,

PLR-107636-00

2000, in which you requested rulings under section 355 of the Internal Revenue Code. Additional information regarding your request has been submitted in letters dated May 5, June 26, July 6, and July 10, 2000. The material information submitted for consideration is summarized below.

Distributing is an accrual basis State X corporation operating on a 52-53 week fiscal year ending on the Saturday nearest December 31. Distributing is engaged directly and indirectly, through its subsidiaries, in Businesses A, B, C, D, and E. Each of these businesses has been conducted for more than five years. Distributing has outstanding a shares of voting common stock, which is owned by Shareholder 1 (b%), Shareholder 2 (c%), and Shareholder 3 (c%).

Controlled is a corporation to be formed under the laws of State X for the purpose of independently operating Business E. Controlled will have outstanding a shares of voting common stock, all of which will be held initially by Distributing. Controlled will have no securities outstanding.

The taxpayer has supplied financial information which indicates that Distributing's businesses A, B, C, D, and E each had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

The hazardous nature of Business B subjects Business E to possible significant environmental liabilities under various state and federal statutes, including the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) and the Resource Conservation and Recovery Act (RCRA). The insurance policies of Distributing do not include coverage for environmental liability.

In addition, Distributing has demonstrated that defects in the products manufactured by Business B and accidents associated with the operations of Business A, Business C, and Business D may produce significant liabilities.

Accordingly, in order to protect Business E from the risks of Distributing's other businesses, Distributing has proposed the following transaction:

- (i) Distributing will transfer all of the Business E assets to Controlled in exchange for all of the issued and outstanding stock of Controlled and the assumption by Controlled of the liabilities associated with Business E.
- (ii) Distributing will then distribute all of the issued and outstanding stock of Controlled to Shareholder 1, Shareholder 2, and Shareholder 3 on a pro-rata basis.

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

PLR-107636-00

- (a) 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 Distributing.
- (b) The five years of financial information submitted on behalf of Distributing is representative of its present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (d) The distribution of the stock of Controlled is carried out for the following corporate business purpose: risk reduction. The distribution of the stock of Controlled is motivated, in whole or substantial part, by such corporate business purpose.
- (e) 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).
- (f) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing or Controlled after the transaction.
- (g) 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.
- (h) 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.
- (i) 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 plus any liabilities to which the transferred assets are subject.
- (j) 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.
- (k) The income tax liability for the taxable year in which the investment credit

PLR-107636-00

property is transferred is not required to be adjusted (pursuant to §50(a)(1)) as a result of the transaction, because the transaction is one to which § 381(a) applies.

- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of the distribution of Controlled stock. There is no plan or intention for there to be any intercorporate debt between Distributing and Controlled subsequent to the distribution of Controlled stock, except as may arise in the ordinary course of business. Any subsequent debt arrangement would not constitute stock or securities of Controlled.
- (n) 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.
- (o) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (p) No Distributing shareholder or shareholders will hold immediately after the distribution disqualified stock within the meaning of § 355(d)(3) which constitutes a 50% or greater interest in Distributing or Controlled.
- (q) The distribution is not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50% or more of the combined voting power of all classes of stock entitled to vote of either Distributing or Controlled, or stock possessing 50% or more of the total value of all classes of stock of either Distributing or Controlled.

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

- (a) The transfer of the assets of Business E by Distributing to Controlled, solely in exchange for all of the issued and outstanding stock of Controlled and the assumption by Controlled of the liabilities associated with the transferred assets, followed by the distribution of all of the Controlled stock to Shareholder 1, Shareholder 2, and Shareholder 3 will be a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled will each be "a party to a reorganization" within the meaning of section 368(b).
- (b) No gain or loss will be recognized by Distributing upon the transfer of the

PLR-107636-00

Business E assets to Controlled in exchange for the stock of Controlled and the assumption by Controlled of the liabilities associated with the transferred assets (sections 361(a) and 357(a)).

- (c) No gain or loss will be recognized by Controlled upon the receipt of the Business E assets in exchange for the Controlled stock (section 1032(a)).
- (d) The basis of each asset received by Controlled from Distributing will be the same as the basis of that asset in the hands of Distributing immediately prior to the transaction (section 362(b)).
- (e) The holding period of each asset received by Controlled from Distributing will include the period during which such assets were held by Distributing (section 1223(2)).
- (f) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder 1, Shareholder 2, and Shareholder 3 upon the receipt of the Controlled stock (section 355(a)(1)).
- (g) No gain or loss will be recognized by Distributing on the distribution of the Controlled stock to Shareholder 1, Shareholder 2, and Shareholder 3 (section 361(c)).
- (h) The aggregate basis of the Distributing stock and the Controlled stock in the hands of Shareholder 1, Shareholder 2, and Shareholder 3 immediately after the distribution will be the same as the basis of the Distributing stock in the hands of Shareholder 1, Shareholder 2, and Shareholder 3 immediately prior to the distribution (section 358(a)(1) and section 1.358-1(a)). Such aggregate basis will be allocated between the Distributing stock and the Controlled stock in proportion to the relative fair market value of each corporation's stock in accordance with section 1.358-2(a)(2) of the Income Tax Regulations (section 358(b)).
- (i) The holding period of the Controlled stock received by Shareholder 1, Shareholder 2, and Shareholder 3 will include the holding period of the Distributing stock with respect to which the distribution will be made, provided that the Distributing stock is held as a capital asset on the date of the distribution (section 1223(1)).
- (j) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under section 1.312-10(a).

No opinion is expressed or implied about the tax treatment of the proposed transaction under other provisions of the Code and Regulations or about the tax

PLR-107636-00

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.

This ruling letter 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.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to your authorized representatives.

by: Sincerely,  
Associate Chief Counsel (Corporate)  
Charles M. Levy  
Reviewer, CC:CORP:2