

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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Date:

September 28, 2001

Distributing =
Controlled =
Shareholder 1 =
Shareholder 2 =
Shareholder 3 =
Shareholder 4 =
Shareholder 5 =
Shareholder 6 =
Shareholder 7 =
Estate =
Trust =
X =
Y =
Business A =
State B =
a =
b =
c =

d =

e =

f =

This letter responds to your November 13, 2000 request for rulings on certain aspects of a proposed transaction (the Proposed Transaction). The information submitted in such request and subsequent correspondence is summarized below.

The rulings contained in this letter are based upon the 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 a ruling. Verification of the information, representations, and other data may be required as part of the audit process.

Summary of Facts

Distributing and its wholly owned subsidiary, Controlled, each conduct Business A. Distributing's only outstanding stock is voting common. Controlled has two outstanding classes of stock: voting common and non-voting common. Distributing stock is owned by Group 1 (which consists of Shareholder 1, Shareholder 2, who is the child of Shareholder 1, and Shareholders 3 and 4, who hold stock beneficially for X, who is also a child of Shareholder 1), Group 2 (which consists of Shareholder 5, and Shareholders 6 and 7, who hold stock beneficially for Y, who is Shareholder 5's child), Estate and Trust.

Shareholder 1 and Shareholder 5 are co-personal representatives of Estate, which holds approximately f% of Distributing's stock. Over the next several years, approximately 90% of the Distributing and Controlled stock held by Estate will be redeemed in § 303 redemptions. For purposes of any shareholder vote with respect to Distributing, shares owned by Estate will not be counted if Shareholder 1 and Shareholder 5, as co-representatives, are deadlocked as to how to vote the Distributing stock held by Estate. Upon the termination of Estate, all of the remaining Distributing stock held by Estate will be distributed to Shareholder 1 and all of the Controlled stock held by Estate will be distributed to Shareholder 5.

Shareholder 1 and Shareholder 5 are each b% beneficiaries of Trust, which holds approximately c% of Distributing's stock. Under the governing provisions of Trust, the trustees must administer the assets for the benefit of all the beneficiaries of Trust but the trustees are not required to follow any directions or requests of such beneficiaries. Such provisions do not give the beneficiaries the power to remove a trustee. Upon termination of Trust, the Distributing stock held by Trust will be distributed to Shareholder 1, if living, and otherwise to his issue, and the Controlled stock held by

Trust will be distributed to Shareholder 5, if living, and otherwise to her issue.

We have received financial information indicating that Business A has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Serious disputes have arisen between Shareholder 1 and Shareholder 5 that are having an adverse effect on the day-to-day operation of Distributing. To eliminate these disputes the parties have proposed the following transaction (the "Proposed Transaction"), which has been partially completed:

(i) Distributing recently transferred a percent of its Business A assets to newly formed Controlled in exchange for all the Controlled stock and the assumption by Controlled of related liabilities (the "Transfer").

(ii) Distributing will distribute the Controlled voting stock to each member of Group 2 in exchange for all of their Distributing stock, and will distribute Controlled non-voting stock to each of Estate and Trust in exchange for a percent of each of their respective holdings of Distributing stock (the "Distribution").

After the Distribution, Trust will own c% and Estate will own f% of Distributing's outstanding stock.

Effective immediately after the Distribution, Trust will give Shareholder 1 an irrevocable proxy, for the term of Trust, with regard to the voting of the Distributing shares held by Trust. For the duration of Trust, neither the bylaws nor the articles of incorporation of Distributing will be amended to increase the required percentage of votes needed for shareholder approval of any matter requiring shareholder approval thereunder. In addition, Distributing's board of directors will not attempt to affect the required level of shareholder approval with respect to any matter presented to shareholders for a vote through any other means under the law of State B. Shareholder 5 has agreed not to participate in the affairs of Distributing or to attempt to influence the trustees of Trust concerning any shareholder vote by Distributing shareholders.

Representations

The taxpayer has made the following representations concerning the Transfer and Distribution:

(a) The fair market value of the Controlled stock received by each of Shareholder 5, Shareholder 6, Shareholder 7, Estate and Trust (collectively, the "Exchanging Shareholders") will approximately equal 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 the Exchanging Shareholders as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) The five years of financial information submitted on behalf of Business A represents its present operations and there have been no substantial operational changes since the date of the last financial statement submitted.

(d) Following the Distribution, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing before the consummation of the Proposed Transaction.

(e) The Distribution will be carried out to eliminate shareholder disputes that, if permitted to continue, would jeopardize the operation and continued success of Business A. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(f) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the Distribution, except as described above (regarding § 303 redemptions and the termination of Estate and Trust) and except that Shareholder 1 and Shareholder 5 may, at some time, transfer some of his or her Distributing or Controlled stock as gifts to such respective shareholder's spouse or lineal descendants.

(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 Distribution, other than any § 303 redemptions described above and other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

(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 Distribution, except as described above and except in the ordinary course of business.

(i) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing in the Transfer will or did at the time of transfer (as the case may be), in each instance, equal or exceed the liabilities assumed (as determined under § 357(d) of the Internal Revenue Code) by Controlled.

(j) The liabilities to be assumed or which (as the case may be) have been assumed (as determined under § 357(d)) in the Transfer 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 investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 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.

(l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.

(m) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.

(n) Payments made in connection with any continuing transactions 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 Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(p) 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 percent or more of the total combined voting power of all classes of Distributing or Controlled stock entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.

(q) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing or Controlled to make an S corporation election pursuant to § 1362(a).

Rulings

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

(1) The Transfer, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under § 368(b).

(2) No gain or loss will be recognized by Distributing on the Transfer (§ 361(a) and § 357(a)).

(3) No gain or loss will be recognized by Controlled on the Transfer (§ 1032(a)).

(4) The basis of each asset received by Controlled in the Transfer will equal the basis of that asset in the hands of Distributing immediately before the transfer (§ 362(b)).

(5) The holding period of each asset received by Controlled in the Transfer will include the period during which Distributing held that asset (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Exchanging Shareholders on the Distribution (§ 355(a)(1)).

(8) The basis of Controlled stock in the hands of each of each member of Group 2 will equal the basis of the Distributing stock surrendered by such shareholder in exchange therefor (§ 358(a)(1)).

(9) The aggregate basis of the Distributing and Controlled stock in the hands of each of Estate and Trust immediately after the Distribution will in each case equal the basis in the Distributing stock held by such shareholder immediately before the Distribution, allocated in proportion to the fair market value of the Distributing and Controlled stock held by such shareholder immediately after the Distribution, in accordance with section 358(b)(2), section 358(c), and section 1.358-2(a)(2).

(10) The holding period of Controlled stock received by each Exchanging Shareholder will include the holding period of the Distributing stock surrendered in the exchange, provided the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(11) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a).

Caveats and Procedural Statements

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.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each taxpayer involved in this transaction should attach a copy of this ruling letter

to the taxpayer's federal income tax return for the taxable year in which the transaction covered by this letter is completed.

Under the power of attorney on file in this office, copies of this letter are being sent to Distributing's authorized representative.

Sincerely yours,
Associate Chief Counsel
(Corporate)
By: Stephen P. Fattman
Chief, Branch 4