

Internal Revenue Service

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Distributing =

H =

W =

Controlled =

state X =

state Y =

business a =

year 1 =

b =

c =

date d =

date e =

date f =

This letter responds to a request dated June 11, 1999, submitted on your behalf by your authorized representative, for rulings on the federal income tax consequences

of a proposed transaction. Additional information was submitted in letters dated July 28, 1999 and August 5, 1999. The information submitted for consideration is summarized below.

Distributing, a state X corporation, is an accrual basis corporation engaged in business a, principally in state X and state Y. Since year 1, H and W, formerly husband and wife, have owned b and c percent, respectively, of Distributing's only class of stock and have been its key employees.

Controlled is a state Y corporation formed to effectuate the proposed transaction. Controlled has outstanding 100 shares of voting common stock, all of which are held by Distributing.

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

H and W were divorced on date f, and their split up has not been amicable. Although their management styles and business philosophies have always differed, their differences escalated dramatically before the divorce. Increasingly, these conflicts are having an adverse effect on the day-to-day operations of Distributing. They have now reached a point where it is obvious they can no longer coexist in a business relationship (either with the business held by one corporation or by a parent and subsidiary corporation). Based on the above, H and W now desire to go their separate ways.

In order to eliminate the problems generated by this situation, the following transaction has been proposed and partially consummated:

- (i) Controlled was formed as a state Y corporation and its charter was issued on date d.
- (ii) Controlled issued 100 shares of voting common stock to Distributing on date e.
- (iii) Distributing is in the process of transferring all the assets and liabilities of its business a in state Y to Controlled in constructive exchange for additional shares of Controlled common stock.
- (iv) Distributing will distribute to H in a non pro rata distribution all of the outstanding Controlled common stock in exchange for all of the Distributing stock owned by H.

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

- (a) The fair market value of the Controlled stock to be received by H will be approximately equal to the fair market value of the Distributing stock surrendered by H 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 5 years of financial information submitted on behalf of Distributing is representative of its present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted other than the contribution of the state Y assets to Controlled.
- (d) Following the transaction, 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 prior to the consummation of the transaction.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purpose: The separation will resolve the acute management and operational differences between H and W that are exacerbated and escalating as long as the business is operated in a single corporation or through an affiliated group. The separation will allow H and W to run his or her business without interference from the other. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) 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).
- (g) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of the stock in either Distributing or Controlled after the transaction.
- (h) 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.
- (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 subsequent to the proposed transaction, except in the ordinary course of business.

- (j) 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.
- (k) 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.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (m) Although an investment tax credit has been claimed on some property being transferred to Controlled by Distributing, the recapture periods for those claimed credits have long since expired.
- (n) No continuing transactions between Distributing and Controlled are contemplated.
- (o) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv) of the Code.
- (p) The distribution of the Controlled stock is not part of a plan or series of related transactions (within the meaning of section 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 stock of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

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

- (1) The transfer by Distributing to Controlled of the assets described above solely in constructive exchange for additional stock of Controlled and the assumption of certain liabilities, as described above, followed by the distribution of the Controlled stock to H in exchange for all of H's Distributing stock, 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).
- (2) Distributing will recognize no gain or loss upon its transfer of assets, subject to liabilities, to Controlled in constructive exchange for additional Controlled stock (§§ 361(a) and 357(a)).

- (3) Controlled will recognize no gain or loss on its receipt of assets in constructive exchange for Controlled stock (§ 1032(a)).
- (4) Controlled's basis in the assets received from Distributing as described above will equal the basis of such assets in the hands of Distributing immediately prior to the transfer (§ 362(b)).
- (5) Controlled's holding period in the assets received from Distributing in the proposed transaction will include the period during which Distributing held such assets (§ 1223(2)).
- (6) Distributing will recognize no gain or loss upon its distribution of its Controlled stock to H in exchange for all of H's Distributing stock (§ 361(c)(1)).
- (7) H will recognize no gain or loss (and no amount will be included in the income of H) on his receipt of the Controlled stock in exchange for all of his Distributing stock (§ 355(a)(1)).
- (8) H's basis of the Controlled stock received in the proposed transaction will equal the basis of the Distributing stock surrendered in exchange therefor (§358(a)(1)).
- (9) H's holding period of the Controlled stock received in the proposed transaction will include the holding period of the Distributing stock surrendered in exchange therefor, provided that H held such stock as a capital asset on the date of the exchange (§ 1223(1)).
- (10) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) of the Income Tax Regulations.

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.

The above rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) of the Code provides that these rulings 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 your authorized representative.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Ken Cohen_____

Ken Cohen

Senior Technician Reviewer, Branch 3