Internal Revenue Service

Department of the Treasury

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Distributing =
Corp Y =
A =
B =
Business X =

We respond to your December 23, 1999 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

The rulings in this letter are based on the facts and representations submitted under penalties of perjury in support of the request. Verification of that information may be required as part of the audit process.

Distributing is owned equally by siblings A and B. Distributing acquired Business X (its only business) in 1998 when it merged with Corp Y (also owned equally by A and B) (the “Merger”). A and B represent that the Merger qualified as a reorganization under § 368(a)(1)(A) of the Internal Revenue Code in which no gain or loss was recognized. Distributing has no assets other than those associated with Business X.

Financial documentation has been submitted which indicates that Business X has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Because of disputes between A and B regarding the operation and direction of Distributing, it is proposed that Business X be divided as follows:

(i) Distributing will contribute approximately one-half of the Business X assets to newly formed, wholly owned Controlled 1 in exchange solely for Controlled 1 stock and the assumption by Controlled 1 of related liabilities.

(ii) Distributing will contribute the remaining Business X assets to newly formed, wholly owned Controlled 2 in exchange solely for Controlled 2 stock and the assumption by Controlled 2 of related liabilities (together with the contribution in step (i), the "Contributions").

(iii) Distributing will distribute the Controlled 1 stock to A in exchange for A's Distributing stock, and the Controlled 2 stock to B in exchange for B's Distributing stock (together, the "Distributions"). Distributing then will liquidate.

The taxpayers have made the following representations concerning the proposed transaction:

(a) The fair market value of the Controlled 1 stock received by A and the Controlled 2 stock received by B will, in each case, approximately equal the fair market value of the Distributing stock surrendered in exchange therefor.

(b) No part of the consideration 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 five years of financial information submitted on behalf of Distributing represents its present operations, and with regard to these operations, there have been no substantial changes since the date of the last financial statements submitted.

(d) Distributing and Controlled each will continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of Business X conducted by Distributing before the transaction.

(e) The Distributions will be carried out to resolve disputes between A and B regarding the operation and direction of Distributing. The Distributions are motivated, in whole or substantial part, by this corporate business purpose.

(f) There is no plan or intention by A or B to sell, exchange, transfer by gift, or otherwise dispose of any stock in Controlled 1 or Controlled 2 after the proposed transaction.

(g) There is no plan or intention by either Controlled 1 or Controlled 2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the proposed transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

(h) There is no plan or intention to liquidate either 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 proposed transaction, except in the ordinary course of business.

(i) The total adjusted basis and the fair market value of the assets transferred to each of Controlled 1 and Controlled 2 by Distributing in the Contributions will, as to each of basis and value, equal or exceed the liabilities assumed (as determined under § 357(d)) by the recipient corporation.

(j) The liabilities assumed (as determined under § 357(d)) in the proposed transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

(k) No intercorporate debt will exist between or among Distributing, Controlled 1, and Controlled 2 at the time of, or after, the Distributions.

(l) Payments made in any continuing transactions between Controlled 1 and Controlled 2 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm’s length.

(m) No two parties to the proposed transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(n) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Controlled 1 or Controlled 2 to make an S corporation election under § 1362(a).

(o) Neither Distribution is 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 stock of either Distributing or Controlled entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

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

(1) Each Contribution and Distribution will be a reorganization under § 368(a)(1)(D). Distributing, Controlled 1, and Controlled 2 each will each be "a party to a reorganization" under § 368(b).

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

(3) No gain or loss will be recognized by Controlled 1 or Controlled 2 on the Contributions (§ 1032(a)).

(4) The basis of each asset received by Controlled 1 or Controlled 2 in the Contributions will equal the basis of that asset in the hands of Distributing immediately before its transfer (§ 362(b)).

(5) The holding period of each asset received by Controlled 1 or Controlled 2 in the Contributions will include the period during which Distributing held that asset (§ 1223(2)).

(6) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) A or B on his receipt of Controlled 1 or Controlled 2 stock in exchange for Distributing stock (§ 355(a)(1)).

(7) The basis of the Controlled 1 stock in the hands of A, and the Controlled 2 stock in the hands of B, will equal the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

(8) The holding period of the Controlled 1 stock received by A, and the Controlled 2 stock received by B, will include the holding period of the Distributing stock surrendered in exchange therefor, provided the Distributing stock is held as a capital asset on the date of the exchange (§ 1223(1)).

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

(10) As provided in § 312(h), proper allocation of earnings and profits between Controlled 1 and Controlled 2 will be made under § 1.312-10(a) of the Income Tax Regulations.

We express no opinion about the tax treatment of the proposed transaction under any other provision 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 in the above rulings. In particular, no opinion is expressed on the question of whether the Merger qualified as a reorganization under § 368(a)(1)(A).

This 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.

A copy of this letter must be attached to the federal income tax return of each taxpayer involved for the taxable year in which the proposed transaction is consummated.

Sincerely,
Assistant Chief Counsel (Corporate)
By: Wayne T. Murray
Senior Technician/Reviewer
Branch 4