

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:2- PLR-127042-00

Date:

March 23, 2001

Legend:

Distributing =

Controlled =

Significant
Shareholder =

Business V =

Business W =

X =

Y =

State Z =

Dear:

This letter responds to your representative's November 15, 2000 request for rulings on certain federal income tax consequences of a proposed transaction. Additional information was received on March 6, 2001. The material information submitted for consideration is summarized below.

Distributing is a State Z corporation engaged in Business V. Distributing has two classes of stock outstanding, Class A voting stock and Class B non-voting stock.

Controlled is a State Z corporation engaged in Business W. Controlled is wholly-owned by Distributing and is the sole subsidiary of the consolidated group of which Distributing is the common parent. As such, both corporations are on a calendar taxable year.

The principal purpose of the proposed transaction is to accomplish the separation of the two businesses in a way which results in the ownership of Controlled by the shareholder who is involved in the business of Controlled, while the remaining shareholders and management of Distributing continue in the ownership and management of the separate business of Distributing. Significant Shareholder, who owns X% of Distributing's Class B stock which equals Y% of the total common stock (both classes considered), is involved in the management of Controlled through her husband. Significant Shareholder's husband has been employed as the general manager of Controlled for many years, effectively functioning as its CEO and COO. Neither Significant Shareholder nor her husband are otherwise involved in the business of Distributing. The other shareholders of Distributing are interested in the business of Distributing, and have no further interest in continuing the business of Controlled. The ownership and management of Distributing have concluded that the complete separation of the two businesses would benefit the business of Distributing by allowing the complete dedication of all its management, financial, and other resources to the business of Distributing without the distraction of the business of Controlled.

The following transaction is proposed for the reasons set forth above:

- (1) Controlled will make a distribution of cash to Distributing in the amount of \$300,000. This distribution is necessary to reduce the value of Controlled's stock to the value of Significant Shareholder's Distributing stock.
- (2) Distributing will distribute to Significant Shareholder 100% of Controlled ("the Distribution").
- (3) Significant Shareholder will surrender all of her Class B Distributing stock.

Financial information has been received which indicates that Distributing and Controlled each have gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

In connection with the proposed transaction, the following additional representations are made:

- (a) The fair market value of the Controlled stock and other consideration to be received by Significant Shareholder will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in exchange.
- (b) No part of the consideration to be distributed by Distributing will be received

by Significant 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 is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(d) The five years of financial information submitted on behalf of Controlled is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(e) Following the transaction, the Distributing and Controlled corporations will each continue the active conduct of its business, independently and with its separate employees.

(f) The Distribution is being carried out for the purposes set forth above. The Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.

(g) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled.

(h) There is no plan or intention by Distributing, 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 Rev. Proc. 96-30.

(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 after the Distribution, except in the ordinary course of business.

(j) Controlled is neither assuming liabilities nor receiving assets subject to liabilities.

(k) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the transaction.

(l) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transactions regulations. Further, Distributing's excess loss account with respect

to the Controlled stock will be included in income immediately before the Distribution.

(m) The indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

(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) 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 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.

(p) Less than 50 percent of the total combined voting power of all classes of Distributing stock entitled to vote and less than 50 percent of the total value of shares of all classes of Distributing stock will have been acquired by purchase under § 355(d)(5) or (8) during the five-year period ending on the date of the Distribution (determined after applying § 355(d)(6)).

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

(1) Distributing will recognize no gain or loss upon the distribution of all of its Controlled stock to Significant Shareholder, as described above (§ 355(c)(1)).

(2) Significant Shareholder will recognize no gain or loss (and no amount will be included in the income of) upon receipt of the Controlled stock in the Distribution, as described above (§ 355(a)(1)).

(3) The basis of the Controlled stock in the hands of Significant Shareholder immediately after the Distribution will equal the basis of her Distributing stock surrendered in exchange therefore (§ 358(a)(1)).

(4) Significant Shareholder's holding period in the Controlled stock received in the Distribution will include the holding period of the Distributing stock held by her, provided that such stock is held as a capital asset on the day of the Distribution (§ 1223(1)).

(5) As provided in § 312(h), a proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) and 1.1502-33(e)(3).

(6) The distribution of cash from Controlled to Distributing prior to the transaction in order to make the value of Controlled correspond to the value of the Distributing stock surrendered will not prevent the proposed transaction from coming within the provisions of § 355 (See Rev. Rul. 56-655, 1956-2 CB 214).

No opinion is expressed regarding the tax treatment of the transaction under any other section of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered in the above rulings.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Assistant Chief Counsel (Corporate)

By: Lewis K Brickates
Assistant to Chief, Branch 2