

Internal Revenue Service

Department of the Treasury

Number: **200145029**
Release Date: 11/9/2001
Index Number: 355.01-01

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:3-PLR-108768-01
Date:
August 9, 2001

Distributing =
Controlled =
A =
B =
State X =
Date 1 =
Employee =
Business 1 =
Segment 1 =
Segment 2 =
a =
b =
c =
d =
e =
f =
g =

We respond to your authorized representative's letter of February 6, 2001, requesting rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated March 8, 2001, March 28, 2001, May 17, 2001, June 4, 2001, June 15, 2001, June 21, 2001, July 9, 2001, and August

PLR-108768-01

3, 2001. The information submitted for consideration is summarized below.

Distributing, a State X corporation, owns a percent (which is more than 80 percent) of Controlled, a State X corporation. The remaining stock of Controlled is owned by Employee. Distributing and Controlled both use the accrual method of accounting and have a taxable year ending on Date 1. Both Distributing and Controlled are engaged in Business 1. However, Distributing operates Segment 1 and Controlled is currently operating Segment 2 which is an expansion of Segment 1.

Individual B owns b percent of the common stock of Distributing. Corporation A owns the remaining common stock and all of the nonvoting preferred stock.

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

B would like to concentrate more on Segment 2 while A would like to concentrate on Segment 1. Therefore, the taxpayers have proposed the following transaction:

Distributing will transfer the following to B in exchange for all of his Distributing stock (the "Exchange"): (a) all of Distributing's Controlled stock, (b) \$ c in cash, (c) a \$ d promissory note with interest payable at e percent, a term of f years, which will be partially secured by a line of credit, and guaranteed by A, and (d) a \$ g deferred cash payment to be made f years following the Exchange ((b) through (d), above, are hereinafter referred to as the "Other Consideration").

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

- (a) The fair market value of the Controlled stock and the Other Consideration to be received by B will be approximately equal to the fair market value of the Distributing stock surrendered by B in the Exchange.
- (b) No part of the consideration to be distributed by Distributing pursuant to the Exchange will be received by B 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 each Segment 1 and Segment 2 is representative of its present operations, and with regard to each of these businesses, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the Exchange, each of Distributing and Controlled will continue the active conduct of its respective business, independently and with its separate employees (except that, following the Exchange, B will be employed for transition

PLR-108768-01

purposes by both Distributing and Controlled for a period not to exceed one year).

- (e) The Exchange is carried out for the following corporate business purpose: To enable B to concentrate on the business of Controlled and A to concentrate on the business of Distributing. The Exchange 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 on the part of A or B to sell, exchange, transfer by gift, or otherwise dispose of any of their respective stock in either Distributing or Controlled after the Exchange.
- (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 Exchange.
- (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 any of the assets of either corporation subsequent to the Exchange, except in the ordinary course of business.
- (j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Exchange.
- (k) 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.
- (l) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (m) 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 Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.

Based solely on the information submitted and representations made, we hold as follows:

PLR-108768-01

- (1) No gain or loss will be recognized to Distributing on the Exchange (§ 355(c)).
- (2) B will recognize gain, if any, but not loss, on his receipt of Controlled stock and Other Consideration in exchange for all his Distributing stock, but not in excess of the fair market value of the Other Consideration (§ 356(a)(1)). The gain shall be treated as gain from the exchange of property (§ 356(a)(2) and Rev. Rul. 93-62, 1993-2 C.B. 118).
- (3) The holding period of the Controlled stock to be received by B will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset on the date of the distribution (§ 1223(1)).
- (4) B's basis in the stock of Controlled after the Exchange will equal the basis of the Distributing stock surrendered, decreased by the fair market value of the Other Consideration and increased by the amount of gain recognized on the Exchange (§ 358(a)(1)).
- (5) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(b).

We express no opinion about the tax treatment of the proposed transaction under other provisions of the Internal Revenue Code and regulations or about 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 is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

It is important that a copy of this letter 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.

Sincerely yours,
Associate Chief Counsel (Corporate)
By: Filiz A. Serbes
Chief, Branch 3