

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

August 13, 1999

Distributing = .

Controlled =

State X =

A =

B =

C =

business a =

business b =

Dear

This letter replies to a request for rulings dated December 2, 1998, on the federal income tax consequences of a proposed transaction concerning § 355 of the Internal Revenue Code. We received additional information in letters dated May 27 and August 12, 1999. The information submitted for consideration is summarized below.

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Distributing is a State X company whose stock is held by members of a family, A, B, and C. Distributing conducts business a on the accrual method of accounting. It owns all of the stock of Controlled with which it files a consolidated federal income tax return.

Controlled is also a State X corporation which uses the accrual method of accounting. It engages in business b.

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

B is more interested in managing business a which is conducted by Distributing while A and C are more interested in managing business b which is carried on by Controlled. Accordingly, the following transaction has been proposed:

- (i) Distributing will distribute all of the Controlled stock to A and C in exchange for all of their Distributing stock.

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) The fair market value of the Controlled stock received by A and C approximately equals the fair market value of the Distributing stock to be surrendered by them 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 five years of financial information submitted on behalf of Distributing and Controlled are representative of each corporation's present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, Distributing and Controlled will each continue the active conduct of the a and b businesses, independently, and with its separate employees.
- (e) The distribution of stock of Controlled is being carried out for the following corporate business purpose: to allow the shareholders to focus their attentions on the business which interests them most. The distribution of the stock of

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Controlled 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 of their stock in either Distributing or Controlled after the transaction.
- (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 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 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 transaction, except in the ordinary course of business.
- (i) No assets of Distributing are being transferred to Controlled and no liabilities are being assumed by Controlled as part of the transaction .
- (j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (k) Payments made in connection with all continuing transactions between Distributing and Controlled, if any, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's-length.
- (l) 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).
- (m) Immediately before the distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Further, Distributing's excess loss account with respect to the Controlled stock will be included in income immediately before the distribution.
- (n) The distribution 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.

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

- (1) Neither A nor C will recognize gain or loss (and no amount will be included in the income of A or C) upon the receipt of the Controlled stock in exchange for all of their Distributing stock, as described above (§ 355(a)(1)).
- (2) Distributing will not recognize gain or loss upon the distribution of all of its Controlled stock (§ 355(c)).
- (3) A and C 's basis in their Controlled stock will, in each instance, equal their aggregate basis in the Distributing stock surrendered in the exchange (§ 358(a)(1)).
- (4) The holding period of the Controlled stock received by A and C will include the holding period of the Distributing stock surrendered in the exchange, provided that the Distributing stock is held as a capital asset on the date of the exchange (§ 1223(1)).
- (5) Proper allocation of, and adjustments to, earnings and profits between Distributing and Controlled will be made in accordance with §§ 1.312-10(b) and 1.1502-33 of the Income Tax Regulations.

We express no opinion about the tax treatment of the proposed 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 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 affected taxpayer must attach a copy of this letter to the taxpayer's federal income tax return for the tax year in which the transaction covered by this ruling letter is consummated.

We have sent a copy of this letter to the taxpayer as designated on the power of attorney on file in this office.

Sincerely yours,

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Assistant Chief Counsel (Corporate)

By \_\_\_\_\_  
Ken Cohen  
Senior Technician Reviewer, Branch 3