

**Internal Revenue Service**

**Department of the Treasury**

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

**December 29, 2000**

Distributing =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

Business X =

Business Y =

Date a =

Date b =

We respond to your June 8, 2000 request for a letter ruling supplementing our letter ruling PLR 199943038 dated July 2, 1999 (the "Prior Letter Ruling"). This supplemental letter ruling revokes the Prior Letter Ruling and addresses the federal tax consequences of the currently proposed transaction. The information submitted in the

Prior Letter Ruling, the current 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.

### **Summary of Facts**

Distributing is engaged in Business X and Business Y. As of Date a, Distributing's single class of stock is owned in equal parts by two families as follows:

<u>Family A</u>	<u>Percentage</u>	<u>Family F</u>	<u>Percentage</u>
A Estate	23.86	F	22.88
B	6.54	G	13.56
C	6.54	H	<u>13.56</u>
D	6.52		50.00
E	<u>6.54</u>		
	50.00		

A died on Date b (after July 2, 1999, the date of the Prior Letter Ruling). Because J, A's wife, has disclaimed A's stock under § 2518 of the Internal Revenue Code, A's shares will pass under A's will to B, C, D, and E, except for shares J will purchase for cash to provide the A Estate with increased liquidity. J will gift the purchased shares to B, C, D, and E. A and F were siblings. B, C, D, and E are children of A and J. G and H are children of F. I, a sibling of A and F, has gifted shares representing less than 50 percent of the vote and value of Distributing stock over a period of years in equal parts to Family A and Family F. I is no longer a shareholder.

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

### **Business Purpose and Proposed Transaction**

Because of disputes between Family A and Family F regarding the direction and operation of Distributing, the following transaction has been proposed to place Business Y under the control of Family A operating Business Y and Business X under the control of Family F:

- (i) Distributing will transfer the Business X assets to newly formed Controlled in exchange solely for Controlled stock and the assumption by Controlled of related liabilities (the "Contribution").

- (ii) Distributing will distribute all of the Controlled stock to F, G, and H in exchange, in each case, for all of the shareholder's Distributing stock (the "Distribution").
- (iii) B, C, E, and D's spouse each will receive a cash payment from Controlled in exchange for a covenant not to compete with Business X.

Within six months after the proposed transaction, F will gift F's Distributing shares to G and H. All stock gifts have been and will be pursuant to established gift-giving programs.

### **Representations**

The following representations have been made concerning the proposed transaction:

(a) The fair market value of the Controlled stock received by each of F, G, and H will approximately equal the fair market value of the Distributing stock surrendered by each in the exchange.

(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 regarding 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 business.

(e) The Distribution will be carried out to resolve disputes between Family A and Family F regarding the direction and operation of Distributing. The Distribution 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 (except for F's gift of Controlled stock to G and H and J's purchase and gift of Distributing stock to B, C, D, and E), or otherwise dispose of any stock in Distributing or Controlled after the proposed 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 proposed transaction.

(h) 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 of these corporations 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 Controlled by Distributing in the Contribution will, in each case, equal or exceed the sum of the liabilities assumed (as determined under 357(d)) by Controlled.

(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 property for which an investment tax credit has been or will be taken will be transferred in the Contribution.

(l) Distributing has neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the proposed transaction.

(m) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.

(n) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled (including the payments described in (iii) above) will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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

(p) 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).

(q) 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.

### **Rulings**

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

(1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under § 368(b).

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

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

(4) The basis of each asset received by Controlled in the Contribution 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 in the Contribution 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) F, G, and H on their receipt of Controlled stock in exchange for Distributing stock in the Distribution (§ 355(a)(1)).

(7) The basis of the Controlled stock in the hands of F, G, and H will in each case equal the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

(8) The holding period of the Controlled stock received by F, G, and H will in each case 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 Distribution (§ 361(c)).

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

### **Caveats**

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, we express no opinion on the tax treatment of the possible transfer of certain life insurance policies to present

or former Distributing shareholders.

### **Procedural Information**

This letter revokes the Prior Letter Ruling. It 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.

Under a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

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