Internal Revenue Service

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Department of the Treasury

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Refer Reply To:
CC:DOM:CORP:2 - PLR-111603-98
Date: November 17, 1998

In re:

Distributing =

Controlled 1 =

Controlled 2 =

Business X =

Individual A =

Individual B =

Employee 1 =

Employee 2 =

Date X =

This responds to your letter dated April 28, 1998, requesting rulings as to certain income tax consequences of a proposed transaction. Additional information was submitted in letters dated July 1, 1998, August 17, 1998, October 13, 1998, and November 16, 1998. The information submitted for consideration is summarized below.

Distributing is an accrual method corporation engaged in Business X. It files its federal

income tax returns on a calendar year basis. Distributing has a single class of stock outstanding. Individual A and Individual B each own fifty percent of Distributing's outstanding stock. Controlled 1 and Controlled 2 are corporations that were formed as part of the proposed transaction. Prior to the transactions described below, Distributing will own all of the outstanding stock of Controlled 1 and Controlled 2.

Financial information has been submitted and the taxpayer represents that at the time of the transaction, Business X will have had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Serious disputes have arisen between Individual A and Individual B that are having an adverse effect on Distributing's day to day operation of Business X. To eliminate these disputes, the following transactions have been proposed:

(i) Distributing will transfer a portion of its assets to Controlled 1 in exchange for additional common stock of Controlled 1 and the assumption of related liabilities by Controlled 1. The assets transferred to Controlled 1 will reflect the value of the holdings of Individual A in Distributing. Distributing will transfer the remaining portion of its assets to Controlled 2 in exchange for additional common stock of Controlled 2 and the assumption of related liabilities by Controlled 2. The assets transferred to Controlled 2 will reflect the value of the holdings of Individual B in Distributing.

(ii) Distributing will distribute all of the Controlled 1 stock to Individual A and all of the Controlled 2 to Individual B in exchange for all of their respective Distributing stock ("Distributions").

(iii) Concurrent with the Distributions, Distributing will dissolve.

The following representations have been made concerning the proposed transactions:

(a) At the time of the Distributions, Distributing will distribute all of the outstanding stock of Controlled 1 to Individual A and will distribute all of the outstanding stock of Controlled 2 to Individual B. No cash or other property of any kind will be distributed to either Individual A or Individual B.

(b) The fair market value of the stock of Controlled 1 to be received by Individual A will be approximately equal to the fair market value of the Distributing stock surrendered by Individual A in the exchange. The fair market value of the stock of Controlled 2 to be received by Individual B will be approximately equal to the fair market value of the Distributing stock surrendered by Individual B in the exchange.

(c) The fair market value of Controlled 1 will approximately equal the fair market value of Controlled 2.

(d) No portion of the consideration to be distributed by Distributing will be received by Individual A or Individual B as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(e) The five years of financial information submitted for Distributing is representative of the business' present operation, and with regard to Distributing, there has been no substantial operational changes since the date of the last financial statement submitted, except as described in this private letter ruling.

(f) Immediately after the distribution of the stock to Individual A and Individual B, Controlled 1 and Controlled 2 will each continue in the active conduct of their retail businesses, independently, directly and with separate employees, except as noted below.

Employee 1 will provide joint computer support for Controlled 1 and Controlled 2 for six months following the Distributions. During such period subsequent to the Distributions, Controlled 1 will invoice Controlled 2 for one-half of the time Employee 1 spends on joint matters and for all of the time spent on matters relating solely to Controlled 2. Subsequent to the period during which Employee 1 will provide services to both subsidiaries, Controlled 2 will make other arrangements for similar services.

Employee 2 will provide joint support (financial and administrative services) for both Controlled 1 and Controlled 2 for three months following the Distributions. During such period subsequent to the Distributions, Controlled 2 will invoice Controlled 1 for one-half of the time spent by Employee 2 on joint corporate matters and for all the time he spends on matters relating solely to Controlled 1. Subsequent to the period during which Employee 2 will provide services to both subsidiaries, Controlled 1 will make other arrangements for similar services.

(g) There is no plan or intention by either Individual A or Individual B to sell, exchange, transfer by gift, or otherwise dispose of any of the stock of Distributing, Controlled 1 or Controlled 2 subsequent to the Distributions.

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

(i) Except for the plan to liquidate Distributing subsequent to the Distributions, there is no plan or intention to (i) liquidate Controlled 1 or Controlled 2, (ii) merge Distributing, Controlled 1 or Controlled 2 with any other corporation, or (iii) sell or otherwise dispose of the assets of Distributing, Controlled 1 or Controlled 2 subsequent to the proposed transaction, except in the ordinary course of business.

(j) In each instance, the total adjusted bases and fair market value of the assets transferred

to Controlled 1 and Controlled 2 by Distributing will each equal or exceed the sum of the liabilities assumed by Controlled 1 and Controlled 2 plus any liabilities to which the transferred assets are subject. The liabilities assumed by Controlled 1 and Controlled 2 and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

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

(l) No intercorporate debt will exist between Distributing and either Controlled 1 or Controlled 2 at the time of, or subsequent to, the distribution of the stock of Controlled 1 or Controlled 2.

(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 (See § 1.1502 13 and § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account, if any, with respect to the Controlled 1 and Controlled 2 stock will be included in income immediately before the distribution (See § 1.1502-19).

(n) Payments made in connection with all 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.

(o) No two parties to the transaction are investment companies in § 368(a)(2)(F)(iii) and (iv) of the Internal Revenue Code.

(p) Distributing, Controlled 1, Controlled 2, Individual A and Individual B will each pay their own expenses, if any, incurred in connection with the proposed transaction.

(q) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no present plan or intention to make S corporation elections for either Distributing, Controlled 1 or Controlled 2 pursuant to § 1362(a).

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

(1) Distributing's transfer of its assets to Controlled 1 and Controlled 2, as described above, in exchange for the stock of Controlled 1 and Controlled 2 and the assumption by Controlled 1 and Controlled 2 of the liabilities related to the assets transferred, followed by the distribution of the shares of Controlled 1 to Individual A and the distribution of the shares of Controlled 2 to Individual B, will in each instance, be a reorganization within the meaning of § 368(a)(1)(D). Distributing, Controlled 1 and Controlled 2 will each be "a party to a

reorganization" within the meaning of § 368(b).

(2) Distributing will recognize no gain or loss on its transfer of assets, as described above, to either Controlled 1 or Controlled 2 in exchange for shares of stock of Controlled 1 or Controlled 2 and the assumption of certain liabilities of Distributing by Controlled 1 or Controlled 2. See §§ 361(a) and 357(a)).

(3) Neither Controlled 1 nor Controlled 2 will recognize gain or loss on their receipt of assets of Distributing in exchange for shares of their stock and the assumption of liabilities. See § 1032.

(4) The basis in the assets that Controlled 1 and Controlled 2 received from Distributing will equal the basis of such assets in the hands of Distributing immediately prior to the transfer. See § 362(b).

(5) The holding period of the assets received by Controlled 1 and Controlled 2 from Distributing will include the period during which Distributing held such assets. See § 1223(2).

(6) Distributing will recognize no gain or loss on the distribution of all of the stock of Controlled 1 to Individual A or on the distribution of all of the stock of Controlled 2 to Individual B. See § 361(c)(1).

(7) Individual A will not recognize gain or loss (and no amount will be included in the income of Individual A) upon his receipt of the stock of Controlled 1 in exchange for his stock in Distributing, as described above. See § 355(a)(1).

(8) Individual B will not recognize gain or loss (and no amount will be included in the income of Individual B) upon his receipt of the stock of Controlled 2 in exchange for his stock in Distributing, as described above. See § 355(a)(1).

(9) The aggregate basis of the stock of Controlled 1 and Controlled 2 in the hands of Individual A and Individual B will be, in each instance, the same as the basis of the stock of Distributing held by Individual A and Individual B, respectively, prior to the distribution. See § 358(a).

(10) The holding period of the stock of Controlled 1 and Controlled 2 received from distributing by Individual A and Individual B will, in each instance, include the holding period of the stock of Distributing held by each before the distribution, provided that Individual A and Individual B each held the distributing stock as a capital asset on the date of the distribution. See § 1223(1).

(11) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled 1 and Controlled 2 must be made under § 1.312-10(a).

The rulings contained in this letter are predicated upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by the appropriate party. Additionally, this ruling letter is conditioned on the proposed transaction not occurring prior to Date X. This office has not verified any of the material submitted in support of the ruling request. Verification of the factual information and other data may be required as part of the audit process. No opinion is expressed as to the taxpayer's tax liability for the year involved. A determination thereof will be made by the District Director's office upon audit of the federal income tax return involved.

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

A copy of this letter should be attached to the federal income tax return of the taxpayer for the taxable year in which the transaction covered by this ruling is consummated.

Sincerely yours,
Assistant Chief Counsel (Corporate)

By *Lewis K. Brickates*
Lewis K Brickates
Assistant to the Branch Chief

Enclosures:
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