

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

July 18, 2001

Distributing =

State X =

A =

B =

C =

D =

E =

f =

g =

h =

i =

j =

k =

l =

m =

n =

o =

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p =q =r =s =t =u =v =w =aa =bb =

Business Y =

Asset Y =

Activities =

We respond to your letter dated March 19, 2001, requesting rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated May 7 and July 9, 2001. The information submitted for consideration is summarized below.

Distributing is a State X corporation that was incorporated in Year 1. It uses the cash method of accounting and has a calendar tax year. Distributing is engaged in Business Y and elected to be taxed as an S corporation, within the meaning of § 1361(a) of the Internal Revenue Code, effective Date 2.

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Distributing has outstanding f shares of voting common stock, which are owned by A (g shares), B (h shares), C (i shares), D (j shares), and E (k shares). A, B, C, and D are siblings, and E is a trust established for their widowed mother that will be equally divided among the siblings upon her death.

Financial information has been received that indicates that Business Y has had gross receipts and operating expenses of the active conduct of a trade or business for each of the past 5 years. The shareholders represent that they have spent an estimated l to m hours per year performing Activities for the business of Distributing.

Serious disputes have arisen among the shareholders, which have adversely affected the business operations of Distributing. Accordingly, they propose the following transaction:

- (i) Distributing will form Controlled A, Controlled B, Controlled C, and Controlled D (each known as a "Controlled Corporation" and collectively referred to as the "Controlled Corporations") as wholly owned subsidiaries. The Controlled Corporations will be State X corporations, use the cash method of accounting, elect S corporation status, and have a calendar tax year.
- (ii) Distributing will transfer n percent, based on net fair market value, of Asset Y and other assets to Controlled A in exchange for o shares of stock of Controlled A and the assumption of liabilities by Controlled A; Distributing will transfer p percent, based on net fair market value, of Asset Y and other assets to each of Controlled B and Controlled D in exchange for o shares of stock of each of Controlled B and Controlled D and the assumption of liabilities by each such Controlled Corporation; and Distributing will transfer p percent, based on net fair market value, of Asset Y and other assets to Controlled C in exchange for o shares of stock of Controlled C and the assumption of liabilities by Controlled C.
- (iii) Thereafter, Distributing's shareholders will exchange all of their shares of Distributing stock for all of the outstanding o shares of a Controlled Corporation as follows: A will receive r shares and E will receive v shares of Controlled A; B will receive s shares and E will receive w shares of Controlled B; C will receive t shares and E will receive aa shares of Controlled C; and D will receive u shares and E will receive bb shares of Controlled D; and
- (iv) Distributing will be dissolved, having collectively transferred all of its assets and liabilities to the Controlled Corporations, as described above.

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

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- (a) The fair market value of the stock of each Controlled Corporation received by each of the shareholders of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by each of the shareholders 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 5 years of financial information submitted on behalf of Distributing is representative of the corporation's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statement submitted.
- (d) Following the transaction, each of the Controlled Corporations will continue, independently and with its separate employees, the active conduct of its share of all of the integrated activities of Business Y conducted by Distributing prior to the consummation of the transaction.
- (e) The distribution of the stock of each of the Controlled Corporations is carried out for the following corporate business purposes: to resolve shareholder disputes. The distribution of the stock of each Controlled Corporation is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) Distributing is an S corporation (within the meaning of § 1361(a) of the Internal Revenue Code). Each Controlled Corporation will elect to be an S corporation pursuant to § 1362(a) on the first available date after the distribution, and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or the Controlled Corporations.
- (g) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, have redeemed, or otherwise dispose of any of their stock in any of the Controlled Corporations after the transaction.
- (h) There is no plan or intention by any of the Controlled Corporations, 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, 1996-1 C.B. 696.
- (i) There is no plan or intention to liquidate either Distributing (other than after the Controlled Corporations have been funded and their stock has been distributed, leaving Distributing with no assets or liabilities) or the Controlled Corporations, to merge any of these corporations with any

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other corporation, or to sell or otherwise dispose of the assets of any of the corporations after the transaction, except in the ordinary course of business.

- (j) The total adjusted basis and the fair market value of the assets transferred to each Controlled Corporation by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under § 357(d)) by each Controlled Corporation. The liabilities assumed (as determined under § 357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.
- (k) No investment tax credit determined under § 46 has been (or will be) claimed with respect to any of the property transferred between Distributing and the Controlled Corporations.
- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (m) No indebtedness has been or will be cancelled in connection with the transaction. No intercorporate debt will exist between Distributing and each of the Controlled Corporations at the time of, or subsequent to, the distribution of each of the Controlled Corporations' stock.
- (n) There are no continuing, planned or intended transactions between or among the Controlled Corporations following the distribution, but any payments made in connection with all continuing transactions, if any, will be for fair market value based on the terms and conditions arrived at by the parties bargaining at arm's length.
- (o) None of the parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (p) The distribution is not part of a plan or series of related transaction 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 entitled to vote or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or the Controlled Corporations.

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

- (1) The transfer by Distributing to each Controlled Corporation of a designated portion of its assets in exchange for the stock of each Controlled Corporation and the assumption of liabilities by each Controlled Corporation, as described above, followed by the distribution of all of the

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stock of Controlled A to A and E, Controlled B to B and E, Controlled C to C and E, and Controlled D to D and E in exchange for all of the stock of Distributing owned by such shareholders will qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and the Controlled Corporations each will be a “party to a reorganization” within the meaning of § 368(b).

- (2) No gain or loss will be recognized by Distributing upon the transfer of its assets to the Controlled Corporations solely in exchange for stock of the Controlled Corporations and the assumption of liabilities (§§ 361(a) and 357(a)).
- (3) No gain or loss will be recognized by each Controlled Corporation upon the receipt of its designated portion of Distributing assets in exchange for the stock of each Controlled Corporation (§ 1032).
- (4) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of the Controlled Corporations to the Distributing shareholders as described above (§ 361(c)(1)).
- (5) The basis of the assets received by each Controlled Corporation will be the same as the basis of such assets in the hands of Distributing immediately before their transfer to each Controlled Corporation (§ 362(b)).
- (6) The holding period of the assets transferred to each Controlled Corporation will include the period during which such assets were held by Distributing (§ 1223(2)).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) A, B, C, D, and E upon receipt of Controlled Corporation stock in exchange for their Distributing stock as described above (§ 355(a)(1)).
- (8) The basis of each Controlled Corporation’s stock in the hands of the Distributing shareholders will be the same as the basis of the Distributing stock surrendered by each of them in exchange therefor (§ 358(a)(1)).
- (9) The holding period of the Controlled Corporation stock received by each Distributing shareholder will include the holding period of the Distributing stock surrendered by each of them, provided such stock is held as a capital asset on the date of the transaction (§ 1223(1)).
- (10) As provided in § 312(h), following distribution of the stock of each Controlled Corporation, proper allocation of earnings and profits will be made among Distributing and each Controlled Corporation in accordance

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with § 1.312-10(a) 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 is directed only to the taxpayers who requested it. Section 6110(k)(3) 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 letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to the taxpayer's authorized representative.

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