

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:B03

PLR-142669-04

Date:

January 24, 2005

Legend

Distributing =

Controlled 1 =

Controlled 2 =

Controlled 3 =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Shareholder F =

aa =

bb =

cc =

business m =

state Z =

Dear :

This letter responds to your July 6, 2004 request for rulings on certain Federal tax consequences of a proposed transaction. Additional information was received in letters dated October 7, November 18, 2004, and January 17, 2005. The information submitted for consideration is substantially as set forth below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This Office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the proposed transaction: (i) satisfies the business purpose requirement of §1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see §355(a)(1)(B) of the Internal Revenue Code and §1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see §355(e)(2)(A)(ii) and §1.355-7T).

Distributing is a state Z subchapter S corporation engaged in business m. Distributing has six shareholders. Shareholders A and B own aa percent; Shareholders C and D own bb percent; Shareholders E and F own cc percent of Distributing. Distributing conducts business m on the cash method of accounting and uses a calendar tax year.

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

For what has been represented as a valid business purpose, the following transaction has been proposed:

- (i) Pursuant to a plan of agreement and reorganization, Distributing will cause Controlled 1, 2, and 3 (each, a "Controlled") to be incorporated as state Z corporations. Controlled 1, 2, and 3 will use the cash method of accounting.
- (ii) Distributing will transfer aa, bb, and cc percent of its business assets relating to business m to each of Controlled 1, 2, and 3, respectively, in exchange solely for all of the outstanding stock of Controlled 1, 2, and 3, respectively.
- (iii) Distributing will distribute all of the Controlled 1 stock to Shareholders A and B in exchange for all of their Distributing stock; all of the Controlled 2 stock to Shareholders C and D in exchange for all of their Distributing stock; and all of the Controlled 3 stock to Shareholders E and F in exchange for all of their Distributing stock.
- (iv) Distributing will go out of existence.

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

- (a) The fair market value of the Controlled stock and other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of the Distributing stock exchanged therefor.
- (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 is representative of its present operation, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the proposed transaction, each Controlled will continue, independently and with its separate employees, the active conduct of its share of all integrated activities of the business which were conducted by Distributing prior to consummation of the transaction.
- (e) The distribution of the stock or stock and securities of each Controlled is carried out for the following corporate business purposes.

1. To eliminate the friction and discontent of the existing shareholders.

2. To allow the successor entities and their owners to focus with a heightened intensity for themselves and make decisions that benefit and enhance each operation's independence without being subjected to the wishes and decisions of Distributing and its six shareholders.
3. To significantly reduce the liability exposure presently existing by Distributing and break that exposure into three corporations.

The distribution of the stock of the Controlled corporations is motivated, in whole or substantial part, by one or more of these business purposes.

- (f) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or any of the Controlled corporations or both.
- (g) The aggregate adjusted basis of the property transferred to each Controlled by Distributing does not exceed the fair market value of such property.
- (h) The total adjusted basis and the fair market value of the assets transferred to each Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (as determined by §357(d)) by the Controlled corporation.
- (i) The liabilities assumed in the transaction 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.
- (j) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of this transaction.
- (k) No intercorporate debt will exist between the Controlled corporations at the time of, or subsequent to, the distribution of the Controlled corporations' stock.
- (l) Payments made in connection with all continuing transactions, if any, among the Controlled corporations will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's-length.
- (m) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv).
- (n) The distribution is not part of a plan or series of related transactions (within the meaning of §1.355-7T) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of §355(d)(4)) in Distributing or any of the

Controlleds (including any predecessor or successor of any such corporation).

Based solely on the information submitted and on the representations set forth above, it is held as follows:

- (1) The transfer by Distributing to the Controlled corporations of all of the assets relating to business m solely in exchange for all the stock of the Controlled corporations, as described above, followed by the distribution of all of the Controlled stock to Shareholders A, B, C, D, E, and F in exchange for all of their Distributing stock will be a reorganization within the meaning of §368(a)(1)(D). Distributing and each Controlled will be “a party to a reorganization” within the meaning of §368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of assets to the Controlled corporations in exchange for Controlled stock and the assumption of liabilities, as described above. Sections 361(a) and 357(a).
- (3) The Controlled corporations will recognize no gain or loss on the receipt of assets relating to business m in exchange for Controlled stock. Section 1032(a).
- (4) The basis of each asset received by the Controlled corporations will be the same as the basis of that asset in the hands of Distributing immediately prior to the transaction. Section 362(b).
- (5) The holding period of the assets received by the Controlled corporations will include the period during which these assets were held by Distributing. Section 1223(2).
- (6) Shareholders A, B, C, D, E, and F will not recognize gain or loss (and no amount will be included in the income of those shareholders) upon receipt of the Controlled stock in exchange for Distributing stock, as described above. Section 355(a)(1).
- (7) No gain or loss will be recognized by Distributing upon the distribution of all of its Controlled stock, as described above. Section 361(c)(1).
- (8) The basis of the stock of a Controlled in the hands of Shareholders A, B, C, D, E, and F after the distribution will be the same as the basis of the Distributing stock exchanged therefor. Section 358(a)(1).
- (9) The holding period of the Controlled corporations’ stock received by Shareholders A, B, C, D, E, and F will 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. Section 1223(1).

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

No opinion is expressed about the tax treatment of the proposed transaction under other provisions 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 by the above rulings. In particular, no opinion is expressed regarding: (i) whether the distribution satisfies the business purpose requirement of §1.355-2(b); (ii) whether the proposed transaction is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see §355(a)(1)(B) and §1.355-2(d)); and (iii) whether the distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under §355(e)(2)(A)(ii).

The rulings contained in this letter are based upon the facts and representations submitted by the taxpayers and accompanied by a penalties of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, verification of the information, representations, and other data may be required as part of the examination process.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter should 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,

Ken Cohen

Ken Cohen
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel (Corporate)