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Person to Contact:

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Refer Reply To:

CC:PSI:3 PLR-116826-00

Date:

September 6, 2001

LEGEND

DT =

TC =

Sub1 =

Sub2 =

Sub3 =

Sub4 =

FSC =

Newco =

State1 =

State2 =

Foreign =

D =

G =

K =

I =

Son1 =

PLR-116826-00

Son2 =Son3 =

Date 1 =

Date 2 =

Date 3 =

Dear

This letter is in response to a letter dated August 29, 2000, and subsequent correspondence, written on behalf of DT requesting rulings under §§ 351, 381, 1371 and 1374 of the Internal Revenue Code.

FACTS

DT, a State1 corporation, was incorporated on Date 1, and is the common parent of a consolidated group of corporations. DT currently has five subsidiaries: FSC, a Foreign corporation; Sub1, a State1 corporation; Sub2, a State1 corporation; Sub3, a State2 corporation; Sub4, a State2 corporation. DT, Sub1, Sub2, and Sub3 each have one class of stock authorized and outstanding. DT's shareholders are D, an individual, and TC.

TC is a State1 corporation. In Date 2, TC contributed all its assets to DT in return for common stock in DT in a § 351 exchange. TC is a former C corporation that elected S corporation status under § 1361 effective Date 3. TC currently has voting and non-voting stock authorized and outstanding. The voting and non-voting stock is identical in every way except for the voting rights granted to the voting stock. The shareholders of TC are T, Son1, Son2 and Son3, all of whom are individuals.

DT proposes the following transactions: (1) DT will contribute the stock of FSC to Sub2; (2) the shareholders of DT and TC will create a new corporation, Newco, which will elect S corporation status under § 1361 upon its formation; (3) the shareholders of DT and TC will contribute their stock in DT and TC to Newco in exchange for Newco's stock; (4) Newco will elect qualified subchapter S subsidiary (QSub) status for TC; (5) Newco will elect QSub status for DT; (6) Newco will elect QSub status for Sub1; and (7) Newco will elect QSub status for Sub3.

Following the proposed transactions, Newco will be owned by D, T, Son1, Son2, and Son3, all of whom are individuals and U.S. citizens. Newco will be authorized to issue and will issue voting and non-voting common stock. Except for voting rights granted to the voting stock, the voting and non-voting common stock will be identical.

PLR-116826-00

DT requests the following rulings:

1. D, T, Son1, Son2, Son3, Sub2 and DT will recognize no gain on the transfer of the FSC stock to Sub2 and the transfer will constitute a transaction described in § 351.
2. Newco, TC, DT, Sub1 and Sub3 will recognize no gain or loss as a result of the deemed transfer of assets from TC, DT, Sub1 and Sub3, respectively to Newco pursuant to Newco's QSub elections with respect to TC, DT, Sub1 and Sub3. The deemed liquidations of TC, DT, Sub1 and Sub3 will be treated as a § 1374(d)(8) transaction, and § 1374 will apply accordingly.
3. Newco is subject to the built-in gains tax of § 1374 with respect to the assets it is deemed to receive from TC, DT, Sub1 and Sub3 pursuant to the QSub elections for TC, DT, Sub1 and Sub3.
4. For federal tax purposes, including the built-in gains tax of § 1374, TC, DT, Sub1 and Sub3 shall not be treated as separate corporations, and all assets (other than the stock of TC, DT, Sub1 and Sub3), liabilities, and items of income, deduction, and credit of TC, DT, Sub1 and Sub3 shall be treated as assets, liabilities, and such items (as the case may be) of Newco.
5. The taxable year of TC, DT, Sub1 and Sub3, respectively, will end at the close of the day before their QSub elections become effective, and Newco will succeed to and take into account those attributes of TC, DT, Sub1 and Sub3 described in § 381(c).
6. The step transaction doctrine will not be applied to the transaction to disregard any transaction and each separate transaction will be recognized in its stated order as specified in §§ 1.1361-4(a)(5)(i) and 1.1361-4(b).

DT has made the following representations with respect to the proposed transactions:

- (a) No stock or securities will be issued for services rendered to or for the benefit of Sub2 in connection with the transactions and no stock or securities will be issued for indebtedness of Sub2 or for interest on indebtedness of Sub2.
- (b) DT neither accumulated receivables nor made extraordinary payment of payables in anticipation of the transaction, and Sub2 will report items which, but for the transfer, would have resulted in income or deduction to DT in a period subsequent to the transfer and such items will constitute income or deductions to Sub2 when received or paid by it. The proceeds received in collection of the income items will be included as ordinary income in computing the taxable

PLR-116826-00

income of Sub2.

- (c) None of the stock to be transferred is "section 306 stock" within the meaning of § 306(c).
- (d) The transactions are not the result of a solicitation by a promoter, broker, or investment house.
- (e) DT will not retain any rights in the FSC stock that is transferred to Sub2.
- (f) The value of the stock received in exchange for accounts receivable will be equal to the net value of the accounts transferred, i.e. the face amount of the accounts receivable previously included in income less the amount of the reserve for bad debts.
- (g) Any debt relating to the stock being transferred that is being assumed (or to which such stock is subject) was incurred to acquire such stock and was incurred when such stock was acquired, and each transferor is transferring all of the stock for which the acquisition indebtedness being assumed (or to which such stock is subject) was incurred.
- (h) The adjusted basis and the fair market value of the stock to be transferred by DT to Sub2 will be equal to or exceed the sum of the liabilities to be assumed by Sub2 plus any liabilities to which the transferred stock is subject.
- (i) The liabilities to be assumed by Sub2 were incurred in the ordinary course of business and are associated with the stock to be transferred.
- (j) There is no indebtedness between Sub2 and DT and there will be no indebtedness created in favor of DT as a result of the transaction.
- (k) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.
- (l) All exchanges will occur on approximately the same date.
- (m) There is no plan or intention on the part of Sub2 to redeem or otherwise reacquire any stock or indebtedness to be issued in the transaction.
- (n) Taking into account any issuance of additional shares of Sub2 stock; any issuance of stock for services; the exercise of any Sub2 stock rights, warrants, options, preferential rights, or subscriptions; a public offering of Sub2 stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of Sub2 received in the exchange, DT will be in "control" of Sub2 within the

PLR-116826-00

meaning of § 368(c).

- (o) There is no plan or intention by Sub2 to dispose of the transferred property other than in the normal course of business.
- (p) Each of the parties to the transactions will pay its own expenses, if any, incurred in connection with the proposed transactions.
- (q) Sub2 will not be an “investment company” within the meaning of § 351(e)(1) and § 1.351-1(c)(1)(ii).
- (r) DT is not under the jurisdiction of a court in a Title 11 or similar case (within the meaning of § 368(a)(3)(A)) and the stock or securities received in the exchange will not be used to satisfy the indebtedness of such debtor.
- (s) Sub2 will not be a “personal service corporation” within the meaning of § 269A.
- (t) The stock transfers to Newco qualify under § 351.
- (u) No shares of stock of TC, DT, or Sub1 and Sub3 have been redeemed during the 3 years preceding the QSub elections made with respect to TC, DT, and Sub1 and Sub3.
- (v) TC, DT, and Sub1 and Sub3 will not acquire assets in any nontaxable transactions at any time after the date of their respective acquisitions by Newco, and, except as set forth herein, TC, DT, and Sub1 and Sub3 did not acquire assets in any nontaxable transactions except for acquisitions occurring more than three years prior to the date that Newco makes the QSub elections for TC, DT, and Sub1 and Sub3, respectively.
- (w) No assets of TC, DT and Sub1 and Sub3 have been or will be disposed of by Newco, TC, DT, Sub1 or Sub3 except for dispositions in the ordinary course of business and dispositions occurring more than three years prior to Newco's QSub elections with respect to TC, DT, Sub1, and Sub3.
- (x) Except as provided herein, the deemed liquidations of TC, DT, and Sub1 and Sub3 will not be preceded by, nor will they be followed by, the reincorporation in, or transfer or sale to, a recipient corporation (“Recipient”) of any of the business or assets of TC, DT, Sub1 and Sub3, if persons holding, directly or indirectly, more than 20 percent in value of the stock of TC, DT, Sub1 and Sub3 also hold, directly or indirectly, more than 20 percent in value of Recipient. For purposes of this representation, ownership is determined by application of the constructive ownership rules of § 318(a) as modified by § 304(c).

PLR-116826-00

- (y) Prior to making the QSub elections with respect to TC, DT, Sub1 and Sub3, no assets of TC, DT, Sub1 and Sub3 will have been distributed in kind, transferred, or sold to Newco except for (i) transactions occurring in the normal course of business and (ii) transactions occurring more than 3 years prior to Newco's QSub elections with respect to TC, DT, Sub1, and Sub3.
- (z) TC, DT, Sub1 and Sub3 will report all earned income represented by any assets that will be distributed to their shareholders, such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.
- (aa) The fair market value of the assets of TC, DT, Sub1 and Sub3 will exceed their liabilities on the date that the QSub elections are made.
- (bb) There is no intercorporate debt existing between Newco, TC, DT, Sub1 and Sub3 and none has been canceled, forgiven, or discounted, except for transactions occurring prior to the date Newco initially acquired the stock of TC, DT, Sub1 and Sub3.
- (cc) Newco is not an organization that is exempt from federal income tax under § 501 or any other provision of the Code.
- (dd) All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the QSub elections for TC, DT, Sub1 and Sub3 have been fully disclosed.

Based solely on the facts submitted, the representations made, and provided the QSub elections are effective before January 1, 2001, we rule as follows:

1. No gain or loss will be recognized by DT on the transfer of the FSC stock to Sub2 (§ 351(a));

No gain or loss will be recognized by Sub2 on the receipt of the FSC stock in exchange for Sub2 stock (§ 1032(a));

DT's basis in its Sub2 stock will be increased by DT's basis in the FSC stock immediately before the transfer (§ 358(a));

The basis of the FSC stock received by Sub2 in the transfer will equal the basis of the FSC stock in the hands of DT immediately before the transfer (§ 362(a)(1));

The holding period of the FSC stock received by Sub2 in the transfer will include the holding period of the FSC stock in the hands of DT (§ 1223(2)); and

PLR-116826-00

The QSub elections with respect to TC, DT, Sub1 and Sub3 will be considered, for federal tax purposes, as complete liquidations of TC, DT, Sub1 and Sub3, respectively, pursuant to § 332.

2. No gain or loss will be recognized by Newco on the deemed liquidations of TC, DT, Sub1 and Sub3 pursuant to Newco's QSub elections with respect to TC, DT, Sub1 and Sub3, respectively (§ 332(a));

TC, DT, Sub1 and Sub3 will recognize no gain or loss on their deemed liquidations, pursuant to the QSub elections of TC, DT, Sub1 and Sub3, respectively (§ 337(a));

Newco's basis in each asset received in the deemed liquidations as a result of the QSub elections will equal the basis of that asset in the hands of TC, DT, Sub1 and Sub3 immediately before the elections (§ 334(b)(1)); and

Newco's holding period in each asset received in the deemed liquidations as a result of the QSub elections will include the period during which that asset was held by TC, DT, Sub1 and Sub3 (§ 1223(2)).

3. Newco is subject to the built-in gains tax of § 1374 with respect to the assets it is deemed to receive from TC, DT, Sub1 and Sub3 pursuant to the QSub elections for TC, DT, Sub1 and Sub3 (§ 1374(d)(8)). A separate determination of tax is made with respect to the assets of TC, DT, Sub1 and Sub3 that Newco acquires in one § 1374(d)(8) transaction from the assets Newco acquires in another § 1374(d)(8) transaction and from the assets Newco held when it became an S corporation. See § 1.1374-8(b).
4. For federal tax purposes, including the built-in gains tax of § 1374, TC, DT, Sub1 and Sub3 shall not be treated as separate corporations, and all assets (other than the stock of TC, DT, Sub1 and Sub3), liabilities, and items of income, deduction, and credit of TC, DT, Sub1 and Sub3 shall be treated as assets, liabilities, and such items (as the case may be) of Newco.
5. Pursuant to § 381(a) and § 1.381(a)-1, Newco will succeed to and take into account the items of TC, DT, Sub1 and Sub3 described in § 381(c), subject to the conditions and limitations specified in §§ 381, 382, 383, and 384 and the regulations thereunder; and

The taxable years of TC, DT, Sub1 and Sub3 will end at the close of the day before their QSub elections become effective (§§ 1.381(b)-1(a)(1) and 1.1361-4(b)).

6. The step transaction doctrine will not be applied to disregard the transfer of TC,

PLR-116826-00

DT, Sub1 and Sub3 to Newco and the deemed liquidations of TC, DT, Sub1 and Sub3 will be recognized in their stated order (§§ 1.1361-4(a)(5)(i) and 1.1361-4(b)).

We express or imply no opinion as to the tax treatment of the transactions under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings. In particular, we express or imply no opinion as to whether the S corporation election for Newco is valid or whether the Qsub elections that Newco made for TC, DT, SUB1, and Sub 3 are valid. Furthermore, other than the above rulings, we express or imply no opinion with respect to the transfer of stock of FSC to SUB 2.

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

Pursuant to a power of attorney on file with this office, we are sending the original of this letter to you and a copy to the taxpayer.

Sincerely,
Christine Ellison
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)