

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:B05

PLR-116813-22

Date:

December 02, 2022

Legend

Distributing =

Controlled =

Business X =

Business Y =

Individual A =

Individual B =

Individual C =

Individual D =

Individual E =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Bank =

Date 1 =

Date 2 =

State A =

Asset A =

Asset B =

Asset C =

a =

b =

c =

d =

e =

f =

g =

h =

i	=
j	=
k	=
l	=
m	=
n	=
o	=
p	=
q	=
r	=
s	=
t	=
u	=
v	=
w	=
y	=

Dear :

This letter responds to a letter dated September 2, 2022, submitted on behalf of the taxpayer, requesting rulings on certain federal income tax consequences of a series of proposed transactions (the “Proposed Transactions”). The material information submitted in that request is summarized below.

This letter is issued pursuant to Rev. Proc. 2017-52, 2017-41 I.R.B. 283, regarding one or more “covered transactions” under sections 355 and 368 of the Internal Revenue Code (the “Code”). This office expresses no opinion as to any issue not specifically addressed by the rulings below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer 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 rulings, it is subject to verification on examination.

We have made no determination regarding whether the Distribution (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b), (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 section 355(a)(1)(B) and Treas. Reg. § 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 within the meaning of Treas. Reg. § 1.355-8T. See section 355(e)(2)(A)(ii) and Treas. Reg. § 1.355-7.

Summary of Facts

Distributing was formed on Date 1 as a State A corporation. On Date 2, Distributing elected to be treated as a subchapter S corporation for Federal income tax purposes under section 1362(a) of the Code.

Distributing is engaged in Business X, which it operates directly and through a disregarded entity, and Business Y, which is operated by Controlled, a State A corporation wholly owned by Distributing that has elected to be treated as a qualified subchapter S subsidiary for Federal income tax purposes under section 1361(b)(3)(B) of the Code (a "QSub").

Distributing has two classes of stock outstanding, all of which are directly owned by Individuals A, B, C, D, and E, or trusts for their benefit. Distributing's Series A shares represent a percent of the vote and b percent of the value. Distributing's Series B shares represent c percent of the vote and d percent of the value.

Individual A owns e percent of the Distributing Series A shares. Individual B owns f percent of the Distributing Series A shares. Trust 1 owns g percent of the Distributing Series A shares. Trust 2 owns h percent of the Distributing Series A shares. Trust 3 owns i percent of the Distributing Series B shares. Trust 4 owns j percent of the Distributing Series B shares. Trust 5 owns k percent of the Distributing Series B shares. Trust 6 owns l percent of the Distributing Series B shares. Trust 7 owns m percent of the Distributing Series B shares.

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

Over time, a disagreement among Distributing's shareholders has developed over the relative prospects of Business X and Business Y. Individuals A and B believe Business X has stronger prospects than Business Y. Individuals C and D believe Business Y has stronger prospects than Business X. These four shareholders want to operate their preferred business separate and apart from the other shareholders and business. Individual E does not have a strong preference for Business X or Y.

Proposed Transactions

To allow Business X to be operated separately from Business Y, Distributing proposes to split Business Y from Business X in the following steps, which will occur sequentially unless otherwise stated:

1. Trust 7 will transfer n Distributing Series B shares to Trust 8.
2. Distributing will contribute certain business assets of Business Y, Asset A, Asset B, and Asset C to Controlled, and Controlled will assume liabilities associated with the transferred assets of Business Y (the "Contribution").
3. Distributing will cause Controlled to enter into a loan with Bank (the "Controlled Loan"). Controlled will transfer \$o of the Controlled Loan proceeds to Distributing. Distributing will use the loan proceeds from the Controlled Loan it receives from Controlled to reduce the outstanding principal on its loan with Bank (the "Distributing Debt") by \$o.
4. Controlled will amend its articles of incorporation to authorize issuance of p shares of Series A common stock and q shares of Series B common stock to facilitate the Proposed Transactions. Controlled will issue r Series A shares and s Series B shares to Distributing in exchange for Distributing's t shares of Controlled common stock.
5. Distributing will distribute (1) Controlled Series A and Series B shares to Trust 2, Trust 5, Trust 6, and Trust 8 in exchange for all of their Distributing Series A and Series B shares, (2) the remaining u Controlled Series A shares to Trust 1 in exchange for an equivalent number of Distributing Series A shares, and (3) the remaining v Controlled Series B shares to Trust 7 in exchange for an equivalent number of Distributing Series B shares.
6. Controlled will elect under section 1362(a) of the Code to be treated as an S corporation on the first available date, effective as of the date of the Distribution.
7. Under agreements entered into on or before the Distribution, w Controlled Series A shares and y Controlled Series B shares may be transferred in exchange for fair market value consideration by Trust 1 and Trust 8 to Controlled and Individuals C and D (or trusts for their benefit).

Following the Distribution, Distributing will engage in certain continuing business relationships with Controlled (collectively, the “Continuing Relationships”). All of the Continuing Relationships will be governed by contracts with arm’s length terms.

Following the Distribution, Individuals B and E will be employed by Distributing. Individuals A and B will also serve on Distributing’s board. In addition, Individual C will be employed by Controlled and serve on Controlled’s board.

Representations

With respect to the Distribution, except as set forth below, Distributing has made all of the representations in Section 3 of the Appendix to Rev. Proc. 2017-53, 2017-41 I.R.B. 283 in the form set forth therein.

Distributing has made the following alternative representations set forth in Section 3 of the Appendix to Rev. Proc. 2017-52:

Representations 3(a), 8(a), 11(a), 15(a), 22(a), 31(a), and 41(b).

Distributing has not made the following representations, which do not apply to the Proposed Transaction:

Representations 5, 6, 19, 20, 24, 25, 35, 36, 37, 38, 39, and 40.

Distributing has made the following modified representation:

Representation 18: The total adjusted basis and the fair market value of assets transferred by Distributing to Controlled will each equal or exceed the sum of: (a) the total amount of the liabilities assumed (within the meaning of section 357(d), but excluding any liabilities to which section 357(c)(3) applies) by Controlled, and (b) the total amount of any money and the fair market value of other property, if any, received by Distributing and transferred to its shareholders and its creditors.

In addition, except as set forth below, Distributing has made all of the representations in Section 3.04 of Rev. Proc. 2018-53, 2018-43 I.R.B. 667.

Distributing has made the following modified representation:

Representation 4: A portion of the Controlled Loan was obtained to substitute for an equivalent amount of Distributing Debt. Distributing incurred the Distributing Debt that will be satisfied with the Controlled Loan (a) before the request for any relevant ruling is submitted and (b) no later than 60 days before the earliest of the following dates: (i) the date of the first public announcement (as defined in § 1.355-7(h)(10)) of the Divisive Reorganization or a similar transaction, (ii) the

date of entry by Distributing into a binding agreement to engage in the Divisive Reorganization or a similar transaction, and (iii) the date of approval of the Divisive Reorganization or a similar transaction by the board of directors of Distributing.

Rulings

Based solely on the information submitted and representations made, we rule as follows:

1. The Distribution will cause a termination of Controlled's QSub election because Controlled will cease to be a wholly-owned subsidiary of an S corporation. For federal income tax purposes, Controlled will be treated as a new corporation acquiring all of its assets and assuming all of its liabilities from Distributing immediately before the termination of Controlled's QSub election in exchange for the stock of Controlled, pursuant to Treas. Reg. § 1.1361-5(b)(1)(i) and section 1361(b)(3)(B) and (C).
2. The Contribution and the Distribution, together, will be a "reorganization" within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be "a party to the reorganization" within the meaning of section 368(b).
3. Distributing will not recognize gain or loss on the Contribution. Sections 361(a) and 357(a).
4. Controlled will not recognize gain or loss on the Contribution. Section 1032(a).
5. Controlled's basis in each asset received in the Contribution will be the same as the basis of that asset in the hands of Distributing immediately prior to the Contribution. Section 362(b).
6. Controlled's holding period in each asset received in the Contribution will include the period during which Distributing held such asset. Section 1223(2).
7. Distributing will not recognize gain or loss on the Distribution. Section 361(c).
8. Controlled's shareholders will not recognize gain or loss on the receipt of the stock of Controlled in the Distribution. Section 355(a)(1).
9. Each participating shareholder's aggregate basis in its Controlled stock immediately after the Distribution will equal such shareholder's aggregate basis in the Distributing stock surrendered in the Distribution and will be allocated among the shares received in the manner described in Treas. Reg. § 1.358-2(a). Section 358(a)(1) and (b)(1).

10. Each participating shareholder's holding period in its Controlled stock received in the Distribution will include the holding period of the Distributing stock received in exchange therefor, provided that such Distributing stock was held as a capital asset on the date of the Distribution. Section 1223(1).
11. As provided in section 312(h), proper allocation of earnings and profits among Distributing and Controlled will be made in accordance with Treas. Reg. § 1.312-10(a).
12. Distributing's accumulated adjustments account immediately before the transaction will be allocated between Distributing and Controlled in a manner similar to the manner in which Distributing's earnings and profits will be allocated under section 312(h). See Treas. Reg. §§ 1.312-10(a) and 1.1368-2(d)(3)).
13. Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under section 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under section 1361, Controlled will be eligible to make a subchapter S election under section 1362(a) for its first taxable year.

Caveats

Except as expressly provided herein, no opinion is expressed or implied concerning the tax treatment of the Proposed Transactions under any provision of the Code and regulations or the tax treatment of any condition existing at the time of, or effects resulting from, the Proposed Transactions that is not specifically addressed by this letter.

We express or imply no opinion regarding whether the purported shareholder trusts are or were eligible S corporation shareholders, or whether certain other transactions not ruled on in this letter have the tax consequences intended.

Procedural Statements

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.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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

Sincerely,

John Lovelace
Senior Attorney, Branch 3
Office of Associate Chief Counsel (Corporate)

cc: