

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP:1-PLR-115898-99
Date:
March 6, 2000

Re:

Distributing =

Controlled 1 =

Controlled 2 =

Controlled 3 =

Partnership =

Date A =

Date B =

Date C =

A =

B =

C =

D =

E =

F =

G =

H =

Business L =

Business M =

Business N =

State X =

Dear :

This letter is in reply to a letter from your authorized representatives, dated September 23, 1999, requesting rulings on a proposed transaction. Additional information was submitted in a letter dated January 13, 2000. The information submitted for consideration is summarized below.

Distributing, a closely held State X corporation, is an accrual basis, calendar year taxpayer. At the time of the proposed transaction described below, Distributing's assets will consist solely of the stock of Controlled 1, Controlled 2 and Controlled 3. On Date A, Distributing elected to be treated as a small business corporation (S Corporation) under § 1362 of the Internal Revenue Code. Also effective on Date A, Distributing, Controlled 1, Controlled 2 and Controlled 3 ceased filing consolidated federal income tax returns.

Three related individuals, D, E and F, and their families, own all of the stock of Distributing. Distributing has issued and outstanding approximately 440 shares of Class A voting common stock and 4,000 shares of Class B non voting common stock, which are held in the following proportions:

<u>Shareholder</u>	<u>Percentage</u>	
	Class A	Class B
A	10.2	9.7
B	2.9	2.9
C	2.9	2.9
D	27	27.3
E	18.4	18.9

F	18.4	18.9
G	10.1	9.7
H	10.1	9.7

There are no Distributing security holders.

Controlled 1, a State X corporation, is an accrual basis, calendar year taxpayer. Controlled 1 has one class of common stock outstanding, all of which is owned by Distributing. Controlled 1 is directly engaged in Business L. On Date B, Distributing elected to treat Controlled 1 as a qualified subchapter S subsidiary (QSub) under § 1361(b)(3) of the Code.

Controlled 2, a State X corporation, is an accrual basis, calendar year taxpayer. Controlled 2 has one class of common stock outstanding, all of which was owned by Controlled 1 prior to Date B. Controlled 2 is directly engaged in Business M. On Date B, Distributing elected to treat Controlled 2 as a QSub. Also on Date B, Controlled 1 distributed the stock of Controlled 2 to Distributing pursuant to State X law.

Controlled 3, a State X corporation, is an accrual basis, calendar year taxpayer. Controlled 3 has one class of common stock outstanding, all of which is owned by Distributing. As described below, Controlled 3 has been directly engaged in Business N since Date B. On Date B, Distributing elected to treat Controlled 3 as a QSub.

Partnership is a State X limited partnership engaged in Business N. Prior to Date B, Controlled 3 was a general partner of Partnership with an approximately 47 percent general partnership interest. On Date B, Partnership distributed a portion of its Business N assets to Controlled 3. No money was distributed by Partnership in this distribution.

Financial information has been received which indicates that Controlled 1, Controlled 2 and Controlled 3, through its Partnership Business N assets, have each had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Over time, each of the three families has become interested in one of the three businesses of Distributing. Conflicts in operating the businesses have developed among the three families, creating three adverse shareholder groups. Lawsuits have been threatened with regard to the management of the Distributing group. In order to resolve conflicts among the management of Controlled 1, Controlled 2 and Controlled 3 and enhance the operations of each business, Distributing proposes the following transaction, portions of which have already been completed:

- (i) On Date C, Distributing transferred certain real estate assets to Controlled 1, which Controlled 1 uses in Business L. Also on Date C, Distributing transferred certain real estate assets to Controlled 2.
- (ii) Distributing will distribute all of the shares of Controlled 1 to F and H in exchange for their Distributing shares (Distribution 1).
- (iii) Distributing will distribute all of the shares of Controlled 2 to A, B, C and D in exchange for their Distributing shares (Distribution 2).
- (iv) Distributing will distribute all of the shares of Controlled 3 to E and G in exchange for their Distributing shares (Distribution 3).
- (v) Distributing will dissolve pursuant to State X law. There will be no continuing transactions or intercorporate debts between the controlled corporations after the distributions.

The following representations have been made in connection with Distribution 1:

- (a1) Distributing and Controlled 1 will each pay their own expenses, if any, incurred in connection with the proposed transaction.
- (b1) The fair market value of the Controlled 1 stock to be received by F and H will be approximately equal to the value of the Distributing stock surrendered by F and H in the exchange.
- (c1) No part of the consideration to be distributed by Distributing will be received by a shareholder in any capacity other than that of a shareholder of Distributing.
- (d1) The five years of financial information submitted on behalf of Controlled 1 is representative of such corporation's present operations, and with regard to such corporation, there have been no significant operational changes since the date of the last financial statements submitted.
- (e1) Following the proposed transaction, Controlled 1 will continue the active conduct of its business, independently and with its separate employees.

- (f1) The distribution of the stock of Controlled 1 is carried out for the following corporate business purpose: To separate the management of each controlled corporation among the shareholders of Distributing to resolve systemic management problems. The distribution of the stock of Controlled 1 is motivated, in whole or in substantial part, by this corporate business purpose.
- (g1) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled 1 after the transaction, except for the exchange of Distributing shares described above in step (ii).
- (h1) There is no plan or intention by either Distributing or Controlled 1, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, except for the liquidation of Distributing described in step (v), above.
- (i1) There is no plan or intention to liquidate Controlled 1, to merge or combine Controlled 1 with any other corporation, or to sell or dispose of any of the assets of Controlled 1, except in the ordinary course of business.
- (j1) The total adjusted bases and the fair market value of the assets transferred to Controlled 1 by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled 1 plus any liabilities to which the transferred assets are subject.
- (k1) 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.
- (l1) The income tax liability for the taxable year in which investment credit property, if any (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
- (m1) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

- (n1) No intercorporate debt will exist between Distributing and Controlled 1 at the time of, or subsequent to, the distribution of Controlled 1. No intercorporate debt will exist between any of the controlled corporations at the time of, or subsequent to, the distribution of Controlled 1.
- (o1) Payments made in connection with all continuing transactions between Distributing and Controlled 1 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arms' length.
- (p1) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (q1) Distribution 1 is not part of a plan or series of related transactions (within the meaning of § 355(e)), including investments in Distributing or Controlled 1, pursuant to which one or more persons will acquire (except as allowed by § 355(e)) directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled 1, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled 1.
- (r1) The gross assets of Controlled 1 used in Business L have a fair market value in excess of 5 percent of Controlled 1's gross assets, and, after Distribution 1, the gross assets of Controlled 1 used in Business L will have a fair market value in excess of 5 percent of Controlled 1's gross assets.
- (s1) Distributing is an S corporation (within the meaning of § 1361(a)). Controlled 1 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 Controlled 1.

The following representations have been made in connection with Distribution 2:

- (a2) Distributing and Controlled 2 will each pay their own expenses, if any, incurred in connection with the proposed transaction.
- (b2) The fair market value of the Controlled 2 stock to be received by A, B, C and D will be approximately equal to the value of the Distributing stock surrendered by A, B, C and D in the exchange.

- (c2) No part of the consideration to be distributed by Distributing will be received by a shareholder in any capacity other than that of a shareholder of Distributing.
- (d2) The five years of financial information submitted on behalf of Controlled 2 is representative of such corporation's present operations, and with regard to such corporation, there have been no significant operational changes since the date of the last financial statements submitted.
- (e2) Following the proposed transaction, Controlled 2 will continue the active conduct of its business, independently and with its separate employees.
- (f2) The distribution of the stock of Controlled 2 is carried out for the following corporate business purpose: To separate the management of each controlled corporation among the shareholders of Distributing to resolve systemic management problems. The distribution of the stock of Controlled 2 is motivated, in whole or in substantial part, by this corporate business purpose.
- (g2) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled 2 after the transaction, except for the exchange of Distributing shares described above in step (iii).
- (h2) There is no plan or intention by either Distributing or Controlled 2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, except for the liquidation of Distributing described in step (v), above.
- (i2) There is no plan or intention to liquidate Controlled 2, to merge or combine Controlled 2 with any other corporation, or to sell or dispose of any of the assets of Controlled 2, except in the ordinary course of business.
- (j2) The total adjusted bases and the fair market value of the assets transferred to Controlled 2 by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled 2 plus any liabilities to which the transferred assets are subject.
- (k2) 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.

- (l2) The income tax liability for the taxable year in which investment credit property, if any (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
- (m2) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (n2) No intercorporate debt will exist between Distributing and Controlled 2 at the time of, or subsequent to, the distribution of Controlled 2. No intercorporate debt will exist between any of the controlled corporations at the time of, or subsequent to, the distribution of Controlled 2.
- (o2) Payments made in connection with all continuing transactions between Distributing and Controlled 2 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arms' length.
- (p2) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (q2) Distribution 2 is not part of a plan or series of related transactions (within the meaning of § 355(e)), including investments in Distributing or Controlled 2, pursuant to which one or more persons will acquire (except as allowed by § 355(e)) directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled 2, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled 2.
- (r2) The gross assets of Controlled 2 used in Business M have a fair market value in excess of 5 percent of Controlled 2's gross assets, and, after Distribution 2, the gross assets of Controlled 2 used in Business M will have a fair market value in excess of 5 percent of Controlled 2's gross assets.
- (s2) Distributing is an S corporation (within the meaning of § 1361(a)).

Controlled 2 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 Controlled 2.

The following representations have been made in connection with Distribution 3:

- (a3) Distributing and Controlled 3 will each pay their own expenses, if any, incurred in connection with the proposed transaction.
- (b3) The fair market value of the Controlled 3 stock to be received by E and G will be approximately equal to the value of the Distributing stock surrendered by E and G in the exchange.
- (c3) No part of the consideration to be distributed by Distributing will be received by a shareholder in any capacity other than that of a shareholder of Distributing.
- (d3) The five years of financial information submitted on behalf of Controlled 3 is representative of such corporation's present operations, and with regard to such corporation, there have been no significant operational changes since the date of the last financial statements submitted.
- (e3) Following the proposed transaction, Controlled 3 will continue the active conduct of its business, independently and with its separate employees.
- (f3) The distribution of the stock of Controlled 3 is carried out for the following corporate business purpose: To separate the management of each controlled corporation among the shareholders of Distributing to resolve systemic management problems. The distribution of the stock of Controlled 3 is motivated, in whole or in substantial part, by this corporate business purpose.
- (g3) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled 3 after the transaction, except for the exchange of Distributing shares described above in step (iv).
- (h3) There is no plan or intention by either Distributing or Controlled 3, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, except for the liquidation

of Distributing described in step (v), above.

- (i3) There is no plan or intention to liquidate Controlled 3, to merge or combine Controlled 3 with any other corporation, or to sell or dispose of any of the assets of Controlled 3, except in the ordinary course of business.
- (j3) The total adjusted bases and the fair market value of the assets transferred to Controlled 3 by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled 3 plus any liabilities to which the transferred assets are subject.
- (k3) 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.
- (l3) The income tax liability for the taxable year in which investment credit property, if any (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
- (m3) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (n3) No intercorporate debt will exist between Distributing and Controlled 3 at the time of, or subsequent to, the distribution of Controlled 3. No intercorporate debt will exist between any of the controlled corporations at the time of, or subsequent to, the distribution of Controlled 3.
- (o3) Payments made in connection with all continuing transactions between Distributing and Controlled 3 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arms' length.
- (p3) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (q3) Distribution 3 is not part of a plan or series of related transactions (within the meaning of § 355(e)), including investments in

Distributing or Controlled 3, pursuant to which one or more persons will acquire (except as allowed by § 355(e)) directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled 3, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled 3.

- (r3) The gross assets of Controlled 3 used in Business N have a fair market value in excess of 5 percent of Controlled 3's gross assets, and, after Distribution 3, the gross assets of Controlled 3 used in Business N will have a fair market value in excess of 5 percent of Controlled 3's gross assets.
- (s3) Distributing is an S corporation (within the meaning of § 1361(a)). Controlled 3 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 Controlled 3.

Based solely on the information submitted and the representations set forth above, it is held as follows for federal income tax purposes with respect to Distribution 1:

- (1) The transfer of assets by Distributing to Controlled 1, as described above in step (i), plus the assumption by Controlled 1 of any liabilities associated with the transferred assets, in deemed exchange for additional Controlled 1 stock, followed by the distribution of the Controlled 1 stock, as described above in step (ii), will qualify as a reorganization within the meaning of § 368(a)(1)(D) of the Code. Distributing and Controlled 1 will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) No gain or loss will be recognized to Distributing upon the transfer of assets, subject to liabilities, to Controlled 1 in deemed exchange for additional Controlled 1 stock (§§ 361(a) and 357(a)).
- (3) No gain or loss will be recognized to Controlled 1 upon the receipt of Distributing's assets in deemed exchange for Controlled 1 stock (§ 1032(a)).
- (4) The basis of the Distributing assets received by Controlled 1 will be the same as the basis of such assets in the hands of Distributing immediately before such transfer (§ 362(b)).
- (5) The holding period of the Distributing assets received by Controlled 1 will

include the period during which such assets were held by Distributing (§ 1223(2)).

- (6) No gain or loss will be recognized to Distributing upon the distribution of all of the Controlled 1 stock (§ 361(c)(1)).
- (7) No gain or loss will be recognized to (and no amount will be included in the income of) Distributing's shareholders upon the receipt of Controlled 1 stock (§ 355(a)(1)).
- (8) The holding period of the Controlled 1 stock received by each Distributing shareholder will, in each instance, include the holding period of the Distributing stock with respect to which the distribution was made, provided that such Distributing stock is held as a capital asset on the date of Distribution 1 (§ 1223(1)).
- (9) The basis of the Controlled 1 stock in the hands of F and H will, in each instance, be the same as the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).
- (10) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled 1 will be made in accordance with § 1.312-10(a) of the Regulations.

Based solely on the information submitted and the representations set forth above, it is held as follows for federal income tax purposes with respect to Distribution 2:

- (11) The transfer of assets by Distributing to Controlled 2, as described above in step (i), plus the assumption by Controlled 2 of any liabilities associated with the transferred assets, in deemed exchange for additional Controlled 2 stock, followed by the distribution of the Controlled 2 stock, as described above in step (iii), will qualify as a reorganization within the meaning of § 368(a)(1)(D) of the Code. Distributing and Controlled 2 will each be "a party to a reorganization" within the meaning of § 368(b).
- (12) No gain or loss will be recognized to Distributing upon the transfer of assets, subject to liabilities, to Controlled 2 in deemed exchange for additional Controlled 2 stock (§§ 361(a) and 357(a)).
- (13) No gain or loss will be recognized to Controlled 2 upon the receipt of Distributing's assets in deemed exchange for Controlled 2 stock (§ 1032(a)).

- (14) The basis of the Distributing assets received by Controlled 2 will be the same as the basis of such assets in the hands of Distributing immediately before such transfer (§ 362(b)).
- (15) The holding period of the Distributing assets received by Controlled 2 will include the period during which such assets were held by Distributing (§ 1223(2)).
- (16) No gain or loss will be recognized to Distributing upon the distribution of all of the Controlled 2 stock (§ 361(c)(1)).
- (17) No gain or loss will be recognized to (and no amount will be included in the income of) Distributing's shareholders upon the receipt of Controlled 2 stock (§ 355(a)(1)).
- (18) The holding period of the Controlled 2 stock received by each Distributing shareholder will, in each instance, include the holding period of the Distributing stock with respect to which the distribution was made, provided that such Distributing stock is held as a capital asset on the date of Distribution 2 (§ 1223(1)).
- (19) The basis of the Controlled 2 stock in the hands of A, B, C and D will, in each instance, be the same as the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).
- (20) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled 2 will be made in accordance with § 1.312-10(a) of the Regulations.

Based solely on the information submitted and the representations set forth above, it is held as follows for federal income tax purposes with respect to Distribution 3:

- (21) No gain or loss will be recognized to Distributing upon the distribution of all of the Controlled 3 stock.
- (22) No gain or loss will be recognized to (and no amount will be included in the income of) Distributing's shareholders upon the receipt of Controlled 3 stock (§ 355(a)(1)).
- (23) The holding period of the Controlled 3 stock received by each Distributing shareholder will, in each instance, include the holding period of the Distributing stock with respect to which the distribution was made, provided that such Distributing stock is held as a capital asset on the date

of Distribution 3 (§ 1223(1)).

- (24) The basis of the Controlled stock in the hands of E and G will, in each instance, be the same as the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

Based solely on the information submitted and the representations set forth above, it is held as follows for federal income tax purposes with respect to the distribution of Business N assets by Partnership to Controlled 3:

- (25) No gain or loss will be recognized to Controlled 3 on the receipt of the Business N assets (§ 731(a)).
- (26) The basis of the distributed Business N assets in the hands of Controlled 3 after the distribution shall be the same as the adjusted basis of the assets to Partnership immediately before the distribution (§ 732(a)).
- (27) No gain or loss will be recognized to Partnership on the distribution of Business N assets (§ 731(b)).

No opinion is expressed about the tax treatment of the transaction under other provisions of the Internal Revenue Code or the Regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings. Furthermore, no opinion is expressed as to the federal income tax consequences of the QSub elections for Controlled 1, Controlled 2 and Controlled 3.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter (including regulations under § 358(g)) have not yet been adopted. Therefore, this ruling will be modified or revoked if adopted temporary or final regulations are inconsistent with any conclusions in the ruling. See, section 12.04 of Rev. Proc. 2000-1, 2000-1 I.R.B. 4, 46 (January 3, 2000). However, when the criteria in section 12.05 of Rev. Proc. 2000-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

This ruling letter has no effect on any earlier documents and is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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 letter ruling is consummated.

In accordance with the power of attorney on file in this office, copies of this letter are being sent to your authorized representatives.

Sincerely yours,
Assistant Chief Counsel (Corporate)
By: Christopher Schoen
Assistant to the Chief, Branch 1