

Internal Revenue Service

Number: **200510022**

Release Date: 3/11/2005

Index Number: 355.00-00, 368.04-00

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:B02

PLR-145881-04

Date:

November 19, 2004

Legend

Distributing =

Controlled A =

Controlled B =

Controlled C =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Shareholder 6 =

Shareholder 7 =

Shareholder 8 =

Shareholder 9 =

Shareholder 10 =

Shareholder 11 =

Shareholder 12 =

Shareholder 13 =

Shareholder 14 =

Shareholder 15 =

Shareholder 16 =

Shareholder 17 =

Group A Assets =

Group B Assets =

Group C Assets =

Date 1 =

State A =

Business A =

Business B =

X =

Class A =

Class B =

Dear :

This letter responds to your August 25, 2004 request for rulings on certain Federal income tax consequences of a proposed transaction. Additional information was submitted in later correspondence dated October 21, 2004, November 3, 2004, and November 18, 2004. The material information submitted for consideration is summarized 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 corporations or both (see, § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)), and (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 corporations (see, § 355(e)(2)(A)(ii) and § 1.355-7T).

SUMMARY OF FACTS

Distributing is a Subchapter S corporation that was incorporated on Date 1 in State A. Distributing is a family run business that is engaged in Business A. Distributing has Class A and Class B stock, which is issued and outstanding. Class A and Class B are owned in approximate equal parts by two different branches of the family. One branch of the family owns X percent of Class A and just over X percent of Class B. The other branch of the family owns, directly or beneficially, X percent of Class A and just under X percent of Class B.

Financial information submitted by Distributing indicates that Business A has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Serious disputes have arisen over the past several years between the two branches of the family and such disputes have adversely affected Distributing's decisions on the operation of Business A. To enable further development of Business A, to avoid further disputes among the shareholders, and to allow shareholders with divergent interests to separate and pursue their own business and investment goals, the following transaction has been proposed (the "Reorganization"):

- (1) Prior to the Reorganization, Distributing will sell Business B for cash that will be used to redeem the stock owned by Shareholder 17.
- (2) Distributing then will form three subsidiary corporations, Controlled A, Controlled B, and Controlled C (collectively, the "Controlled Corporations").
- (3) Immediately thereafter, Distributing will contribute the Group A Assets to Controlled A, the Group B Assets to Controlled B, and the Group C Assets to Controlled C in exchange for all of the outstanding stock of the Controlled Corporations.
- (4) In exchange for all of the outstanding stock of Distributing, Distributing will distribute the stock of Controlled A to Shareholder Group A (collectively, Shareholders 1-2), the stock of Controlled B to Shareholder Group B (collectively, Shareholders 3-9), and the stock of Controlled C to Shareholder Group C (collectively, Shareholders 10-16) (the "Distributions").
- (5) Distributing will completely liquidate and go out of existence.

REPRESENTATIONS

Distributing has made the following representations regarding the proposed transaction:

- (a) The fair market value of the Controlled Corporation stock to be received by Shareholder Group A, Shareholder Group B, and Shareholder Group C in the Distributions will be approximately equal to the fair market value of Distributing stock surrendered by Shareholder Group A, Shareholder Group B, and Shareholder Group C in the exchanges.
- (b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any other capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operation, and with regard to such corporation, there has been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the Reorganization, the Controlled Corporations will each continue, independently and with separate employees, the active conduct of its share of all the integrated activities conducted by Distributing prior to the Reorganization.
- (e) The distribution of the stock of the Controlled Corporations is carried out for the following corporate business purpose: to enhance the success of the business of Distributing by enabling the resolution of management problems that have arisen and are exacerbated by the operation of the business under the current structure. The Distributions are motivated, in whole or substantial part, by this corporate business purpose.
- (f) Distributing is an S corporation (within the meaning of § 1361(a)). The Controlled Corporations will each elect to be an S corporation pursuant to § 1362(a) on the first available date after the Reorganization, and there is no plan or intent to revoke or otherwise terminate the S corporation elections of the Controlled Corporations.
- (g) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in the Controlled Corporations after the Reorganization.
- (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 Reorganization.

- (i) Distributing will liquidate upon the receipt of its capital stock from its shareholders. There is no plan or intention to liquidate the Controlled Corporations, to merge any of these corporations with any other corporation, or to sell or otherwise dispose of the assets of any of these corporations after the Reorganization, except in the ordinary course of business.
- (j) The total adjusted bases and the fair market value of the assets transferred to the Controlled Corporations by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under § 357(d)) by the Controlled Corporations.
- (k) The liabilities assumed (as determined under § 357(d)) in the Reorganization were incurred in the ordinary course of business and are associated with the assets being transferred.
- (l) No investment tax credit under the Code has been, or will be, claimed with respect to any of the assets being transferred by Distributing to the Controlled Corporations, respectively.
- (m) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Reorganization.
- (n) No intercorporate debt will exist between Distributing and the Controlled Corporations at the time of, or subsequent to, the Distributions.
- (o) 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.
- (p) No two parties to the Reorganization are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (q) Distributing and Shareholder Group A, Shareholder Group B, and Shareholder Group C will each pay their own expenses, if any, incurred in connection with the Reorganization, with Distributing paying the expenses for the Controlled Corporations. Distributing is paying the expenses of Counsel that prepared this private letter ruling request, but Distributing is not paying for separate counsel or advisors for either Shareholder Group A, Shareholder Group B, or Shareholder Group C.
- (r) The cash and investment assets held by Distributing and to be held by the Controlled Corporations are related to the reasonable needs of the conduct of the active trade or business of each corporation or to equalize values.
- (s) The Distributions are 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)) of either Distributing or the Controlled Corporations (including any predecessor or successor of any such corporation).

(t) The Reorganization is not being used principally as a device for the distribution of the earnings and profits of Distributing or the Controlled Corporations, or both.

(u) For purposes of § 355(d), immediately after the Distributions, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distributions.

(v) For purposes of § 355(d), immediately after the Distributions, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of the Controlled Corporations' stock entitled to vote, or 50 percent or more of the total value of shares of all classes of the Controlled Corporations' stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distributions.

RULINGS

Based solely upon the information submitted and representations set forth above, we rule as follows:

(1) Amounts received by Shareholder 17 in the redemption will be treated as full payment in exchange for the Distributing stock surrendered. (Section 331(a)).

(2) The transfer by Distributing of the Group A Assets to Controlled A solely in exchange for all of the stock of Controlled A and the assumption of related liabilities by Controlled A, followed by the distribution by Distributing of the stock of Controlled A to Shareholder Group A solely in exchange for all of the Distributing stock owned by Shareholder Group A will qualify as a reorganization within the meaning of § 368(a)(1)(D) of the Code. Distributing and Controlled A will each be "a party to the reorganization" within the meaning of § 368(b) of the Code.

(3) The transfer by Distributing of the Group B Assets to Controlled B solely in exchange for all of the stock of Controlled B and the assumption of related liabilities by Controlled B, followed by the distribution by Distributing of the stock of Controlled B to Shareholder Group B solely in exchange for all of the Distributing stock owned by Shareholder Group B will qualify as a reorganization within the meaning of

§ 368(a)(1)(D) of the Code. Distributing and Controlled B will each be "a party to the reorganization" within the meaning of § 368(b) of the Code.

(4) The transfer by Distributing of the Group C Assets to Controlled C solely in exchange for all of the stock of Controlled C and the assumption of related liabilities by Controlled C, followed by the distribution by Distributing of the stock of Controlled C to Shareholder Group C solely in exchange for all of the Distributing stock owned by Shareholder Group C will qualify as a reorganization within the meaning of § 368(a)(1)(D) of the Code. Distributing and Controlled C will each be "a party to the reorganization" within the meaning of § 368(b) of the Code.

(5) Distributing will recognize no gain or loss on the transfer of the Group A Assets to Controlled A in exchange for the stock of Controlled A and the assumption of related liabilities. (Section 361(a) and 357(a)).

(6) Distributing will recognize no gain or loss on the transfer of the Group B Assets to Controlled B in exchange for the stock of Controlled B and the assumption of related liabilities. (Section 361(a) and 357(a)).

(7) Distributing will recognize no gain or loss on the transfer of the Group C Assets to Controlled C in exchange for the stock of Controlled C and the assumption of related liabilities. (Section 361(a) and 357(a)).

(8) No gain or loss will be recognized by Controlled A upon the receipt of the Group A assets from Distributing in exchange for all of the Controlled A stock and the assumption of related liabilities. (Section 1032(a)).

(9) No gain or loss will be recognized by Controlled B upon the receipt of the Group B assets from Distributing in exchange for all of the Controlled B stock and the assumption of related liabilities. (Section 1032(a)).

(10) No gain or loss will be recognized by Controlled C upon the receipt of the Group C assets from Distributing in exchange for all of the Controlled C stock and the assumption of related liabilities. (Section 1032(a)).

(11) The basis of each asset received by Controlled A will be the same as the basis of the asset in the hands of Distributing immediately prior to the Reorganization. (Section 362(b)).

(12) The basis of each asset received by Controlled B will be the same as the basis of the asset in the hands of Distributing immediately prior to the Reorganization. (Section 362(b)).

(13) The basis of each asset received by Controlled C will be the same as the basis of the asset in the hands of Distributing immediately prior to the Reorganization. (Section

362(b)).

(14) The holding period of each asset received by Controlled A will include the period during which such asset was held by Distributing. (Section 1223(2)).

(15) The holding period of each asset received by Controlled B will include the period during which such asset was held by Distributing. (Section 1223(2)).

(16) The holding period of each asset received by Controlled C will include the period during which such asset was held by Distributing. (Section 1223(2)).

(17) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder Group A upon its receipt of the stock of Controlled A in exchange for its Distributing stock. (Section 355(a)).

(18) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder Group B upon its receipt of the stock of Controlled B in exchange for its Distributing stock. (Section 355(a)).

(19) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder Group C upon its receipt of the stock of Controlled C in exchange for its Distributing stock. (Section 355(a)).

(20) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of Controlled A. (Section 361(c)(1)).

(21) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of Controlled B. (Section 361(c)(1)).

(22) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of Controlled C. (Section 361(c)(1)).

(23) The basis of the Controlled A stock in the hands of Shareholder Group A immediately after the Distribution will be the same as the basis of the Distributing stock held by Shareholder Group A immediately before the Distribution. (Section 358(a)(1)).

(24) The basis of the Controlled B stock in the hands of Shareholder Group B immediately after the Distribution will be the same as the basis of the Distributing stock held by Shareholder Group B immediately before the Distribution. (Section 358(a)(1)).

(25) The basis of the Controlled C stock in the hands of Shareholder Group C immediately after the Distribution will be the same as the basis of the Distributing stock held by Shareholder Group C immediately before the Distribution. (Section 358(a)(1)).

(26) The holding period of the Controlled A stock received by Shareholder Group A

will include the holding period of Shareholder Group A's Distributing stock exchanged, provided that the Distributing stock is held as a capital asset on the date of the Distribution. (Section 1223(1)).

(27) The holding period of the Controlled B stock received by Shareholder Group B will include the holding period of Shareholder Group B's Distributing stock exchanged, provided that the Distributing stock is held as a capital asset on the date of the Distribution. (Section 1223(1)).

(28) The holding period of the Controlled C stock received by Shareholder Group C will include the holding period of Shareholder Group C's Distributing stock exchanged, provided that the Distributing stock is held as a capital asset on the date of the Distribution. (Section 1223(1)).

(29) As provided in § 312(h), proper allocation of earnings and profits among Distributing, Controlled A, Controlled B, and Controlled C will be made in accordance with § 1.312-10(a) of the Income Tax Regulations.

(30) Distributing's accumulated adjustments account immediately before the Reorganization will be allocated among the Controlled Corporations in a manner similar to the manner in which the earnings and profits of Distributing are allocated under § 312(h).

CAVEATS

No opinion is expressed about the tax treatment of the Reorganization 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 Reorganization that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the Distributions satisfy the business purpose requirement of § 1.355-2(b); (ii) whether the Reorganization is used principally as a device for the distribution of the earnings and profits of Distributing or the Controlled Corporations, or of all four of the corporations (see § 355(a)(1)(B) and § 1.355-2(d)); (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); or (iv) whether any of the Controlled Corporations is otherwise eligible to be taxed as an S corporation and whether any of the Controlled Corporations' elections will be valid under section 1362.

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.

Each taxpayer involved in this transaction must attach a copy of this ruling letter to the taxpayer's Federal income tax return for the year in which the Reorganization is completed.

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

Sincerely,

Jeffrey B. Fienberg
Assistant to the Branch Chief, Branch 2
Office of the Associate Chief Counsel
(Corporate)

cc: