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Date:

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LEGEND

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

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Shareholder Group A =

Shareholder Group B =

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Business A =

Business B =

Business C =

Date A =

a =b =

Dear

This letter responds to your February 5, 2003 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in such request and subsequent correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

SUMMARY OF FACTS

Distributing is a holding company that conducts Business A, Business B, and Business C through subsidiaries. Distributing has one class of voting common stock outstanding. Shareholder Group A owns a percent of Distributing stock and Shareholder Group B owns b percent of Distributing stock. Distributing wholly owns Controlled and Sub 3. Controlled wholly owns Sub 1. Sub 1 wholly owns Sub 2. Sub 3 wholly owns Sub 4. Sub 4 wholly owns Sub 5. Sub 5 wholly owns Sub 6.

Effective Date A, Distributing elected to be an S corporation under § 1362 of the Internal Revenue Code and also elected to treat Controlled, Sub 1, Sub 2, Sub 3, Sub 4, Sub 5, and Sub 6 as qualified subchapter S subsidiaries ("QSubs") under § 1361(b)(3)(B). As a result of the QSub elections, the QSubs are not treated as corporations separate from Distributing for federal income tax purposes.

Sub 1 and Sub 5 conduct Business A. Sub 2 conducts Business B and holds assets used by Sub 1. Sub 6 conducts Business B and holds assets used by Sub 5. Financial information has been received indicating that Business A conducted by Sub 1 and Sub 5 each has had gross receipts and operating expenses representing the conduct of an active business during each of the past five years.

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Serious disputes have arisen between Shareholder Group A and Shareholder Group B that are having an adverse effect on the day-to-day operations of Distributing. To eliminate these differences, it is proposed that Distributing distribute the stock of Controlled to Shareholder Group B in exchange for the Distributing stock held by each shareholder in Shareholder Group B (collectively, the "Distribution").

REPRESENTATIONS

Distributing has made the following representations based on the characterization of the exchange of stock above and by ruling (1) below:

- (a) The fair market value of the Controlled stock received by each shareholder of Shareholder Group B will approximately equal the fair market value of the Distributing stock surrendered in the Distribution.
- (b) No part of the consideration distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than as a Distributing shareholder.
- (c) The five years of financial information submitted on behalf of Sub 1 and Sub 5's Business A represents each corporations' present operations, and with regard to each business there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the Distribution, the gross assets of Distributing, that are treated as directly conducted by Distributing will have a fair market value of at least five percent of the total fair market value of the gross assets of Distributing.
- (e) Following the Distribution, the gross assets of Controlled, that are treated as directly conducted by Controlled will have a fair market value of at least five percent of the total fair market value of the gross assets of Controlled.
- (f) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (g) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing will equal or exceed the liabilities assumed (as determined under § 357(d)) by Controlled.
- (h) The liabilities assumed (as determined under § 357(d)) in the transaction and the liabilities to which the transferred assets are subject to, were incurred in the ordinary course of business and are associated with the assets being transferred.

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- (i) The Distribution will be carried out for the following corporate business purpose: to end shareholder disputes over the operation of Distributing and to resolve management, systemic and other problems that have arisen because of irreconcilable differences between Shareholder Group A and Shareholder Group B. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (j) There is no plan or intention by the Distributing shareholders to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the Distribution.
- (k) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distribution, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.
- (l) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or after the Distribution.
- (n) Payments made in connection with any continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (o) No two parties to the transaction are investment companies as defined by § 368(a)(2)(F)(iii) and (iv).
- (p) For purposes of § 355(d), immediately after the Distribution, no person (determined by 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 Distribution.
- (q) For purposes of § 355(d), immediately after the Distribution, 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 Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of

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Controlled stock, that was either (i) acquired by purchase (as defined in §§ 355(d)(5) and (6)) 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 were acquired by purchase (as defined by §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

- (r) The Distribution is not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50 percent or more of the total combined voting power of all classes of Distributing or Controlled stock entitled to vote, or stock possessing 50 percent or more of the total value of all classes of Distributing or Controlled stock.
- (s) Distributing is an S corporation (within the meaning of § 1361(a)). Controlled will elect to be an S corporation pursuant to § 1362(a) on the first available date after the Distribution and will elect to treat Sub 1 and Sub 2 as QSubs as of that date. There is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

RULINGS

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

- (1) The Distribution will terminate the QSub election of Controlled and any lower-tier QSubs of Controlled. Consequently, immediately before the Distribution, Controlled will be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) from Distributing in exchange for the stock of Controlled (the "Contribution") (§ 1.1361-5(b)(1)(i)).
- (2) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled will each be a "party to a reorganization" under § 368(b).
- (3) No gain or loss will be recognized by Distributing on the Contribution (§ 361(a)).
- (4) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).
- (5) The basis of each asset deemed received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing (§ 362(b)).
- (6) The holding period of each asset deemed received by Controlled will include the

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holding period of that asset in the hands of Distributing (§ 1223(2)).

- (7) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).
- (8) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the shareholders of Shareholder Group B on their receipt of Controlled stock in the Distribution (§ 355(a)(1)).
- (9) The basis of the Controlled stock in the hands of each shareholder of Shareholder Group B will in each case equal the shareholders' basis in the Distributing stock held immediately before the Distribution (§ 358(a)(1)).
- (10) The holding period of the Controlled stock received by each Shareholder Group B shareholder will in each case include the holding period of the Distributing stock surrendered in exchange therefore, provided that the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (11) Earnings and profits will be allocated between Distributing and Controlled in accordance with §§ 312(h) and 1.312-10(a).

CAVEATS

We express no opinion on the federal income tax treatment of the proposed transaction under any other provision 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 in the above rulings. In particular, no opinion is expressed or implied as to whether Distributing is a valid S corporation prior to the Distribution, whether Controlled will be a valid S corporation after the Distribution, whether any of Controlled's subsidiaries will be valid QSubs after the transaction or whether the accumulated adjustment account was properly allocated between Distributing and Controlled.

PROCEDURAL INFORMATION

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 must be attached to any income tax return to which it is relevant.

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Sincerely,

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Corporate)

cc: