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### LEGEND:

Distributing =

Merged Corp =

Controlled Corporation #1 =

Controlled Corporation #2 =

Controlled Corporation #3 =

Controlled Corporation #4 =

Controlled Corporation #5 =

Controlled Corporation #6 =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Shareholder F =

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State A =

a% =

Business XYZ =

Date 1 =

Date 2 =

XX =

Dear :

This letter responds to your June 23, 2003 request for rulings regarding certain federal income tax consequences of a proposed transaction . The information submitted in that request and in later correspondences dated September 23, 2003, October 3, 2003 October 13, 2003 and October 20, 2003 is summarized below.

Distributing was incorporated as a State A "Subchapter C" corporation in State A on Date 1. Distributing directly conducts Business XYZ. Currently Distributing has six shareholders. Shareholder A (a trust), Shareholder B, Shareholder C, Shareholder D, Shareholder E and Shareholder F each own an equal number of shares of Distributing, a%. Merged Corp was incorporated as a State A "Subchapter C" corporation in State A on Date 2. Merged Corp directly conducts Business XYZ. Currently Merged Corp has six shareholders. Shareholder A, Shareholder B, Shareholder C, Shareholder D, Shareholder E and Shareholder F each own an equal number of shares of Merged Corp, a%. With respect to Distributing, currently Shareholders A, B, C, D, E, and F actively participate in Business XYZ. With respect to Merged Corp, currently Shareholders A, B, C, D, E, and F actively participate in Business XYZ.

Financial information has been received indicating that Distributing has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

The shareholders have significantly and continually disagreed over issues such as the management of corporate assets, marketing strategies, types of financing, capital expenditures, the future direction of the businesses, and the long-term growth of the businesses. These disagreements have lead to further disputes relating to the

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day-to-day operations of the corporate businesses. To eliminate these disagreements, the following series of transactions are proposed:

- (i) Merged Corp will merge into Distributing under the laws of State A. Taxpayer has represented that the statutory merger of Corp 1 into Distributing will constitute a reorganization under I.R.C. § 368(a)(1)(A).
- (ii) Distributing will then form six subsidiaries, Controlled Corporation #1, Controlled Corporation #2, Controlled Corporation #3, Controlled Corporation #4, Controlled Corporation #5 and Controlled Corporation #6. ("the Controlled corporations")
- (iii) Immediately thereafter, Distributing will contribute assets to each Controlled corporation in exchange for all of the stock of each corporation. The assets contributed to each of the Controlled corporations, less liabilities assumed, will be of equal value as to each Controlled corporation.
- (iv) Distributing will then distribute all of the stock of Controlled Corporation #1 to Shareholder A in exchange for its interest in Distributing. Distributing will then distribute all of the stock of Controlled Corporation #2 to Shareholder B in exchange for its interest in Distributing. Distributing will then distribute all of the stock of Controlled Corporation #3 to Shareholder C in exchange for its interest in Distributing. Distributing will then distribute all of the Stock of Controlled Corporation #4 to Shareholder D in exchange for its interest in Distributing. Distributing will then distribute all of the stock of Controlled Corporation #5 to Shareholder E in exchange for its interest in Distributing. Distributing will then distribute all of the stock of Controlled Corporation #6 to Shareholder F in exchange for its interest in Distributing.
- (v) Distributing will then be completely liquidated.
- (vi) Immediately after the proposed transaction Controlled Corporation #1 will be actively engaged in Business XYZ. Immediately after the proposed transaction Controlled Corporation #2 will be actively engaged in Business XYZ. Immediately after the proposed transaction Controlled Corporation #3 will be actively engaged in Business XYZ. Immediately after the proposed transaction Controlled Corporation #4 will be actively engaged in Business XYZ. Immediately after the proposed transaction Controlled Corporation #5 will be actively engaged in Business XYZ. Immediately after the proposed transaction Controlled Corporation #6 will be actively engaged in Business XYZ.

The taxpayers have made the following representations in connection with the proposed transaction:

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- (a) The fair market value of the Controlled corporations stock and other consideration received by each shareholder of the Distributing corporation will be approximately equal to the fair market value of Distributing stock surrendered by the shareholder in the exchange.
- (b) The indebtedness owed by the Controlled corporations to the Distributing corporation after the distribution of the Controlled corporations stock will not constitute stock or securities.
- (c) No part of the consideration to be distributed by the Distributing corporation will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (d) The five years of financial information submitted on behalf of the Distributing corporation is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the transaction, each Controlled corporation will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the Business conducted by the Distributing corporation prior to the consummation of the transaction.
- (f) The distribution of the stock of the Controlled corporations is carried out for the following corporate business purposes: to end director disputes and deadlock, including costly corporate litigation arising from such disputes and to permit the shareholders to go their separate ways.
- (g) The Distributing corporation is not an S corporation (within the meaning of § 1361(a)), but immediately before the distribution, the Distributing corporation will be eligible to make an S Corp election pursuant to § 1362(a). The Controlled corporations will elect to be S corporations pursuant to § 1362(a) on the first available day after the distribution, and there is no plan or intent to revoke or otherwise terminate the S corporation election of the Controlled corporations.
- (h) For purposes of Section 355(d), immediately after the distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing corporation stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing corporation stock, that was acquired by

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purchase (as defined in Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date.

- (i) For purposes of Section 355(d), immediately after the distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of any Controlled corporation stock entitled to vote, or 50 percent or more of the total value of shares of all classes of any Controlled corporation stock, that was either (i) acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date, or (ii) attributable to distributions on Distributing corporation stock that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date
- (j) The distributions are not part of a plan or series of related transactions (within the meaning of section 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 stock entitled to vote of either Distributing, Controlled Corporation #1, Controlled Corporation #2, Controlled Corporation #3, Controlled Corporation #4, Controlled Corporation #5 or Controlled Corporation #6, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing, Controlled Corporation #1, Controlled Corporation #2, Controlled Corporation #3, Controlled Corporation #4, Controlled Corporation #5 or Controlled Corporation #6.
- (k) The gross assets of the trade or business that will be relied upon by each Controlled corporation to satisfy the active trade or business requirement of section 355(b) will, in the aggregate, have a fair market value that is not less than five percent of the total fair market value of the gross assets of the company directly operating such trade or business.
- (l) No income items, including accounts receivable or any item resulting from a sale, exchange or disposition of property, that would have resulted in income to the Distributing corporation, and no items of expense will be transferred to the Controlled corporations if the Distributing corporation has earned the right to receive the income or could claim a deduction for the expense under the accrual or similar method of accounting.
- (m) The Distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

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- (n) No intercorporate debt will exist between the Distributing corporation and the Controlled corporations at the time of, or subsequent to, the distribution of the Controlled corporations' stock.
- (o) Payments made in connection with all continuing transactions, if any, between 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 transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (q) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift or otherwise dispose of their stock in, or securities of, a Controlled corporation subsequent to the transaction.
- (r) Distributing will liquidate upon the receipt of its capital stock from its shareholders. There is no plan or intention to liquidate any of the Controlled corporations, to merge any of the Controlled corporations with any other corporation, or to sell or otherwise dispose of the assets of any of the Controlled corporations subsequent to the transaction, except in the ordinary course of business.
- (s) There is no plan or intention by either the Distributing corporation or the Controlled corporations, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (t) The total adjusted basis and the fair market value of the assets transferred to each of the Controlled corporations by the Distributing corporation will, in each instance, equal or exceed the sum of the liabilities assumed (as determined under section 357(d)) by each of the Controlled corporations. The liabilities assumed (as determined under section 357(d)), were incurred in the ordinary course of business and are associated with the assets being transferred.
- (u) Subsequent to the transaction, the trustee of Shareholder A will be eligible to make the election under § 1361(d)(2) as a Qualified Subchapter S Trust or under § 1361(e)(3) as an Electing Small Business Trust for Controlled Corporation #1, and the trust terms and operations meet the requirements of § 1361(d)(2) and § 1361(e)(3), respectively.

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- (v) The merger of Merged Corp into Distributing will be accomplished as required pursuant to and within the meaning of chapter XX of the Revised Code of State A, and is a statutory merger which meets the requirements of section 368(a)(1)(A).

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

1. The transfer by Distributing of all of its assets to each of the six Controlled corporations in exchange for all of their stock, followed by the distribution by Distributing of all of the stock of Controlled Corporation #1, Controlled Corporation #2, Controlled Corporation #3, Controlled Corporation #4, Controlled Corporation #5 and Controlled Corporation #6 to Shareholder A, Shareholder B, Shareholder C, Shareholder D, Shareholder E, and Shareholder F, respectively, in exchange for their respective shares of Distributing stock, constitutes a reorganization within the meaning of I.R.C. section 368(a)(1)(D). Distributing and each of the Controlled corporations will be "a party to a reorganization" within the meaning of I.R.C. section 368(b).
2. No gain or loss will be recognized by Distributing upon its transfer of assets, subject to liabilities, to the Controlled corporations in exchange for the stock of the Controlled corporations. (I.R.C. sections 361(a) and 357(a)).
3. No gain or loss will be recognized by Controlled Corporation #1, Controlled Corporation #2, Controlled Corporation #3, Controlled Corporation #4, Controlled Corporation #5 and Controlled Corporation #6 on their respective receipt of assets of Distributing in exchange for the stock of Controlled Corporation #1, Controlled Corporation #2, Controlled Corporation #3, Controlled Corporation #4, Controlled Corporation #5 and Controlled Corporation #6, respectively. (I.R.C. section 1032(a)).
4. The basis of each asset received by the Controlled corporations will be, in each instance, the same as the basis of such assets in the hands of Distributing (I.R.C. section 362(b)).
5. The holding period of the Distributing assets received by the Controlled corporations will include the period during which such assets were held by Distributing. (I.R.C. section 1223(2)).
6. No gain or loss will be recognized by Distributing upon the distribution of all of its stock in the Controlled corporations to each of its shareholders in exchange for all of the Distributing stock currently held by those shareholders. (I.R.C. section 361(c)(1)).

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7. No gain or loss will be recognized by (and no amount will be includible in the income of) any of the shareholders upon their receipt of stock in a Controlled corporation in exchange for the Distributing stock they currently hold. (I.R.C. section 355(a)(1))
8. The basis of the stock of each of the Controlled corporations in the hands shareholders will be the same as the basis of each shareholder's Distributing stock surrendered in the exchange therefor (I.R.C. section 358(a)(1)).
9. The holding period of the stock in each of the Controlled corporations received by its shareholders will include the holding period of the Distributing stock surrendered in the exchange provided that the Distributing stock is held as a capital asset on the date of the exchange. (I.R.C. section 1223(1)).
10. As provided in I.R.C. section 312(h), proper allocation of earnings and profits among each of the six Controlled corporations will be made under Treas. Reg. section 1.312-10(a).
11. Distributing's momentary ownership of stock of the Controlled corporations as part of the proposed transactions will not cause the Controlled corporations to be ineligible corporations under section 1361(b)(1)(B). Therefore, assuming the Controlled corporations will otherwise meet the requirements of a small business corporation under section 1361, the Controlled corporations will each be eligible to make an S corporation election under section 1362(a) for their first taxable year.
12. The Controlled corporations will be subject to section 1374 with respect to any asset transferred to the Controlled corporations to the same extent Distributing would have been subject to section 1374 with respect to such asset had Distributing made an election to be treated as an S corporation.

We express no opinion about the tax treatment of the transaction under any other section of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered in the above rulings. In particular, no opinion is expressed concerning whether or not the statutory merger of Merged Corp into Distributing under the laws of State A will qualify as a tax free reorganization under section 368(a)(1)(A).

The rulings contained in this letter are based upon information 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.



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

A copy of this ruling letter should be attached to the federal income tax return of each taxpayer involved for the taxable year in which the transaction is consummated.

Sincerely yours,

*Steven J. Hankin*

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Office of Associate Chief Counsel  
(Corporate)