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Distributing has demonstrated that the nature of Business A exposes Business B to liabilities arising from various hazards. Distributing desires to insulate Business B and its assets from the regulations, liabilities, and risks associated with the operation of Business A. We have received information demonstrating that Distributing cannot acquire insurance sufficient to protect the Business B assets from the hazards of Business A. Distributing also has submitted information indicating its belief that the separation of Business A and Business B would achieve significant cost savings, and would enable Business B to compete more successfully in the marketplace. Accordingly, Distributing has proposed the following transaction (the "Proposed Transaction"):

Distributing will form Controlled as a wholly owned subsidiary by transferring all of the assets of Business B to Controlled in exchange for stock of Controlled. Immediately after the formation of Controlled and the transfer of the Business B assets to Controlled, all of the outstanding stock of Controlled will be distributed by Distributing to its shareholders. Controlled will make an S election on the first available date after the transaction.

The following representations have been made in connection with the Proposed Transaction:

- (a) There will be no debt outstanding between Distributing and Controlled after the Proposed Transaction.
- (b) No part of the consideration to be distributed by Distributing will be received by a Shareholder as a creditor, employee or in any capacity other than that as a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing 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, except for the gradual expansion of Business B and a planned section 301 distribution.
- (d) Following the transaction, Distributing and Controlled will continue, independently and with its separate employees, the active conduct of Business A and Business B, respectively.
- (e) The distribution of stock of Controlled is being carried out for the following corporate business purposes: risk reduction, cost savings and to resolve

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problems with competition. The distribution of the stock of Controlled is motivated in whole or in substantial part by these corporate business purposes.

- (f) 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 Distributing or Controlled after the transaction.
- (g) There is no plan or intention by Distributing or Controlled, 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.
- (h) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any corporation, or to sell or otherwise dispose of either corporation's assets after the transaction except in the ordinary course of business.
- (i) The total adjusted basis and fair market value of the assets transferred to Controlled by Distributing equals or exceeds the sum of the liabilities to which the transferred assets are subject. No existing liabilities of Distributing will be assumed by Controlled 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.
- (j) Distributing and Controlled respectively have, and will have, no accumulated earnings and profits at the beginning of their respective taxable years. Distributing and Controlled will have no current earnings and profits as of the date of the Distribution
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (l) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(ii) and (iv) of the Internal Revenue Code.
- (m) The distribution is 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% or more of the total value or total combined voting power of all classes of stock of Distributing or Controlled.

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- (n) No Distributing shareholder or shareholders will hold immediately after the distribution disqualified stock within the meaning of section 355(d)(3) which constitutes a 50-percent or greater interest in Distributing or Controlled.
- (o) There is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

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

- (1) The transfer by Distributing of its Business B assets to Controlled in exchange for Controlled stock, followed by the immediate distribution of all the Controlled stock to the shareholders of Distributing constitutes a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will be "a party to the reorganization" within the meaning of section 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of the Business B assets and related liabilities to Controlled in exchange for the stock of Controlled (sections 361(a) and 357(a)).
- (3) Controlled will recognize no gain or loss upon the receipt of the Business B assets and related liabilities in exchange for shares of stock of Controlled (section 1032(a)).
- (4) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to its transfer to Controlled (section 362(b)).
- (5) The holding period of the Distributing assets received by Controlled will include the period during which such assets were held by Distributing (section 1223(2)).
- (6) The shareholders of Distributing will recognize no gain or loss upon the receipt of the shares of Controlled (section 355(a)(1)).
- (7) Distributing will recognize no gain or loss upon the distribution of stock of Controlled to the shareholders of Distributing (section 361(c)).
- (8) The aggregate basis of the Distributing stock and Controlled stock in the hands of the shareholders of Distributing, immediately after the distribution will be the same as the basis of the Distributing stock in the hands of the shareholders of Distributing immediately prior to the distribution (section 358(a)(1)). Such

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aggregate basis will be allocated between the Distributing stock and the Controlled stock in proportion to the relative fair market value of each corporation's stock in accordance with Treas. Reg. § 1.358-2(a)(2).

- (9) The holding period of the Controlled stock received by the shareholders of Distributing will include the holding period of the Distributing stock with respect to which the distribution will be made, provided that the Distributing stock is held as a capital asset on the date of the distribution (section 1223(1)).
- (10) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under 1.312-10(a) of the Income Tax Regulations.
- (11) Provided that Distributing immediately distributes the stock of Controlled to qualified subchapter S shareholders, Distributing's momentary ownership of the stock in connection with a reorganization under section 368(a)(1)(D) will not cause Controlled to have an ineligible shareholder under section 1361(b)(1)(B).

We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not directly covered by the above rulings.

This ruling letter 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 should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

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.

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,

Mark S. Jennings

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Mark S. Jennings  
Chief, Branch 1  
Office of Associate Chief Counsel  
(Corporate)

cc: