

**Internal Revenue Service**

Department of the Treasury

Number: **200104028**  
Release Date: 1/26/2001  
Index Numbers: 355-00.00;  
368-04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:CORP:2-PLR-115252-00

Date:

October 30, 2000

Legend

Distributing =

Controlled =

X Trust =

Y Trust =

Z Trust =

a =

b =

c =

d =

Business A =

Business B =

State =

Date 1 =

Dear:

This is in response to your authorized representative's letter dated July 17, 2000, requesting rulings under § 355 of the Internal Revenue Code (the "Code") with respect to a proposed transaction. Additional information was received in letters dated September 29, 2000 and October 19, 2000. The material information submitted is summarized below.

Distributing is a State corporation that files its federal income tax return on a calendar year basis. Distributing made a Subchapter S election effective Date 1, and has been an S corporation continuously since then. Distributing has a single class of stock outstanding. Immediately prior to the Distribution discussed below, the

Distributing stock will be owned a% by the X Trust, b% by the Y Trust, and c% by the Z Trust.

Distributing is engaged in Business A and Business B. Financial information has been received indicating that each of Business A and Business B has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five years.

Five key employees (the “Key Employees”) of Business A have expressed a desire to acquire equity in Distributing. Distributing believes it is essential to grant such equity interests to the Key Employees in order to keep them in the employ of Distributing and not of its competitors. The Key Employees desire an equity interest that will give them a meaningful voice in the management of Business A. The Key Employees do not desire an equity interest in Business B, and they could not afford to purchase a significant interest in both lines of business. Furthermore, the Key Employees do not contribute to the value of Business B and Distributing does not want them indirectly to own an interest in Business B. Therefore, as soon as practicable, and in no event more than six months, after the Distribution discussed below, Distributing will issue to the Key Employees an aggregate of d% of Distributing stock pursuant to a share purchase agreement to be entered into by and among Distributing and the Key Employees. In order to retain the Key Employees, Distributing proposes the following series of transactions (the “Distribution”):

1. Distributing will form a subsidiary, Controlled, and will contribute to Controlled the assets of Business B in exchange for 100% of the stock of Controlled and the assumption by Controlled of certain Distributing liabilities related to Business B.
2. Distributing will distribute all of the stock of Controlled pro rata to the Distributing shareholders.

Distributing has made the following representations with respect to the Distribution:

- (a) 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 of a shareholder of the corporation.
- (b) 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.
- (c) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees, with the

exception of the Chief Executive Officer and two other employees, who will be employed by both Distributing and Controlled. Neither the Chief Executive Officer nor either of the two other employees is a Key Employee as described above.

(d) The distribution of the stock, or stock and securities, of Controlled is carried out for the following corporate business purpose: to retain key employees. The distribution of the stock, or stock and securities, of Controlled is motivated in whole or substantial part, by one or more these corporate business purposes.

(e) Distributing is an S corporation within the meaning of section 1361(a) of the Code. Controlled will elect to be an S corporation pursuant to section 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 either Distributing or Controlled.

(f) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the transaction.

(g) 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 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 other corporation, or to sell or otherwise dispose of the assets of either corporation 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 each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.

(j) The liabilities assumed in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

(k) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.

(m) Payments made in connection with all 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.

(n) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

Based solely on the information provided and the representations made, we conclude as follows:

(1) The transfer by Distributing to Controlled of the assets described above in exchange for all the stock of Controlled and the assumption of certain liabilities followed by the distribution of all of the Controlled stock to the shareholders of Distributing, pro rata, in accordance with their shareholdings in Distributing, will be a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled will each be “a party to the reorganization” within the meaning of section 368(b).

(2) No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for the Controlled stock and assumption of liabilities by Controlled, as described above (section 361(a) and section 357(a)).

(3) No gain or loss will be recognized to Controlled on the receipt of the Business B assets in exchange for Controlled stock (section 1032(a)).

(4) The basis of each of the assets to be received by Controlled in the transaction will be the same as the basis of such assets in the hands of Distributing immediately prior to the transaction (section 362(b)).

(5) The holding period of each of the assets to be received by Controlled will include the period during which Distributing held such asset (section 1223(2)).

(6) No gain or loss will be recognized by Distributing upon the distribution of all of its Controlled stock (section 361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will included in the income of) the shareholders of Distributing upon the receipt of Controlled stock as described above (section 355(a)(1)).

(8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of the Distributing shareholders after the Distribution will, in each instance, be the same as the aggregate basis of the Distributing stock held immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with section 1.358-2(a)(2) (section 358(c)).

(9) The holding period of the Controlled stock in the hands of the Distributing shareholders will include the period for which such shareholder held the Distributing stock, provided that such stock is held as a capital asset by such shareholder on the date of the exchange (section 1223(1)).

(10) As provided in Code section 312(h), the earnings and profits of Distributing will be allocated among Distributing and Controlled under Treas. Reg. 1.312-10(a).

No opinion is expressed as to the tax treatment of the transaction under other provisions of the Code or 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 ruling.

This ruling is directed only to the taxpayer that 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 ruling letter is consummated.

In accordance with a 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 Lewis K Brickates  
Assistant to the Chief, Branch 2