

Internal Revenue Service

Department of the Treasury

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Date:

January 12, 2002

Distributing =

Controlled A =

Controlled B =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Business A =

State X =

Date 1 =

Date 2 =

a =

b =

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c =d =e =f =g =h =i =

Dear

This letter responds to your September 10, 2001 request for rulings on certain aspects of a proposed transaction. Additional information was submitted in letters dated November 20, 2001, December 19, 2001, and January 2, 2002. The information submitted in such request and subsequent correspondence is summarized below.

The rulings contained in this letter are based upon the 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 a ruling. Verification of the information, representations, and other data may be required as part of the audit process.

Summary of Facts

Distributing is a State X corporation that was incorporated on Date 1. Distributing files its federal income tax return on a calendar year basis and uses the cash method of accounting. Distributing is engaged directly in Business A and elected to be taxed as an S corporation, within the meaning of § 1361(a) of the Internal Revenue Code, effective Date 2.

Distributing has outstanding a shares of voting common stock, which are owned by Shareholder 1 (b shares), Shareholder 2 (c shares), Shareholder 3 (c shares), Shareholder 4 (c shares), and Shareholder 5 (d shares). Shareholder 1 is the parent of Shareholder 2, Shareholder 3, and Shareholder 4. Shareholder 5 is a trust, the life beneficiary of which is Shareholder 1, who holds a power of appointment over the remainder interest in the trust. Shareholder 1 has provided by will that, upon the death of Shareholder 1, the shares of stock of Distributing, Controlled A, and Controlled B held by Shareholder 5 will be distributed among Shareholder 3, Shareholder 2, and Shareholder 4, respectively.

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Distributing has submitted financial information indicating 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.

Series disputes have arisen among Shareholder 2, Shareholder 3, and Shareholder 4 regarding a number of fundamental business matters affecting Business A. The conflicts among Shareholder 2, Shareholder 3, and Shareholder 4 are having an adverse effect on the daily operations of Business A. To eliminate those disputes, Distributing has proposed the following transaction (the "Proposed Transaction"):

(i) Distributing will form Controlled A and Controlled B as wholly owned subsidiaries incorporated in State X. Controlled A and Controlled B each will have outstanding immediately prior to the Proposed Transaction c shares of voting and e shares of non-voting common stock. Following the Proposed Transaction, Controlled A and Controlled B each will elect to be taxed as S corporations pursuant to § 1362(a).

(ii) Distributing will transfer f percent, based on net fair market value, of its Business A assets to Controlled A in exchange for all of the outstanding stock of Controlled A and the assumption by Controlled A of related liabilities (the "Controlled A Transfer"). Distributing will transfer f percent, based on net fair market value, of its Business A assets to Controlled B in exchange for all of the outstanding stock of Controlled B and the assumption by Controlled B of related liabilities (the "Controlled B Transfer").

(iii) Distributing will distribute all of the Controlled A and Controlled B stock as follows (the "Distributions"): Shareholder 1 will receive g shares of the Controlled A non-voting stock and g shares of the Controlled B non-voting stock in exchange for all of the Distributing stock held by Shareholder 1; Shareholder 2 will receive all of the Controlled A voting stock in exchange for all of the Distributing stock held by Shareholder 2; Shareholder 4 will receive all of the Controlled B voting stock in exchange for all of the Distributing stock held by Shareholder 4; Shareholder 5 will receive h shares of Controlled A non-voting stock and h shares of Controlled B non-voting stock in exchange for i shares of Distributing stock held by Shareholder 5.

(iv) Effective immediately after the Distributions, the trustees of Shareholder 5 will give Shareholder 3 an irrevocable proxy, for the term of the trust, with regard to the voting of the Distributing stock held by Shareholder 5.

Representations

The taxpayer has made the following representations concerning the Controlled A Transfer, the Controlled B Transfer, and the Distributions:

(a) The fair market value of the stock of Controlled A and Controlled B received by each of the Distributing shareholders will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.

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(b) No part of the consideration to be distributed by Distributing will be received by a Distributing shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) The five years of financial information submitted on behalf of Business A represents its present operations and there have been no substantial operational changes since the date of the last financial statement submitted.

(d) Following the Distributions, Distributing, Controlled A, and Controlled B will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of Business A conducted by Distributing before consummation of the Proposed Transaction.

(e) The Distributions will be carried out to eliminate shareholder disputes that, if permitted to continue, would jeopardize the operation and continued success of Business A. 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)). Controlled A and Controlled B each will elect to be an S corporation pursuant to § 1362(a) on the first available date after the Distributions, and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing, Controlled A, or Controlled B.

(g) There is no plan or intention by the Distributing shareholders to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing, Controlled A, or Controlled B after the Distributions, except for transfers by gift to family members.

(h) There is no plan or intention by either Distributing, Controlled A, or Controlled B, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distributions, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

(i) There is no plan or intention to liquidate either Distributing, Controlled A, or Controlled B, to merge any of these corporations with any other corporation, or to sell or otherwise dispose of the assets of any of the corporations after the Distributions, except in the ordinary course of business.

(j) 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.

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(k) 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 stock of either Controlled A or Controlled B entitled to vote, or 50 percent or more of the total value of shares of all classes of stock of either corporation, 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 Distributions 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.

(l) The total adjusted basis and the fair market value of the assets transferred to Controlled A in the Controlled A Transfer and to Controlled B in the Controlled B Transfer by Distributing will, in each instance, equal or exceed the sum of the liabilities assumed (as determined under § 357(d)) by Controlled A and Controlled B, respectively.

(m) The liabilities assumed (as determined under § 357(d)) in the Controlled A Transfer and the Controlled B Transfer were incurred in the ordinary course of business and are associated with the assets being transferred.

(n) The income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.

(o) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.

(p) No intercorporate debt will exist among Distributing, Controlled A, and Controlled B at the time of, or after, the Distributions.

(q) No two parties to the Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(r) Payments made in connection with any continuing transactions among Distributing, Controlled A, and Controlled B will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(s) The Distributions are 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 combined voting power of all classes of stock entitled to vote of either Distributing, Controlled A, or Controlled B, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing, Controlled A, or Controlled B.

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(t) Distributing, Controlled A, Controlled B, and their respective shareholders each will pay their own expenses, if any, incurred in connection with the Proposed Transaction.

Rulings

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

(1) The Controlled A Transfer and the Controlled B Transfer, followed by the Distributions, will each be a reorganization under § 368(a)(1)(D). Distributing, Controlled A, and Controlled B each will be “a party to a reorganization” under § 368(b).

(2) No gain or loss will be recognized by Distributing on both the Controlled A Transfer and the Controlled B Transfer (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled A on the Controlled A Transfer, and no gain or loss will be recognized by Controlled B on the Controlled B Transfer (§ 1032(a)).

(4) The basis of each asset received by Controlled A and Controlled B will equal the basis of that asset in the hands of Distributing immediately before its transfer to either Controlled A or Controlled B (§ 362(b)).

(5) The holding period of each asset received by Controlled A and Controlled B will include the period during which Distributing held that asset (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing on the Distributions (§ 361(c)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Shareholder 1, Shareholder 2, Shareholder 4, and Shareholder 5 on the receipt of stock of Controlled A and Controlled B, as the case may be, in exchange for their Distributing stock (§ 355(a)(1)).

(8) The basis of the stock of Controlled A and Controlled B in the hands of Shareholder 1, Shareholder 2, and Shareholder 4, as the case may be, will equal the basis of the Distributing stock surrendered by such shareholder in exchange therefor (§ 358(a)(1)).

(9) The aggregate basis of the stock of Distributing, Controlled A, and Controlled B in the hands of Shareholder 5 immediately after the Distributions will in each case equal the basis in the Distributing stock held by such shareholder immediately before the Distributions, allocated in proportion to the fair market value of the stock of Distributing, Controlled A, and Controlled B held by such shareholder immediately after the Distributions, in accordance with § 358(b)(2), § 358(c), and § 1.358-2(a)(2).

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(10) The holding period of the stock of Controlled A and Controlled B received by Shareholder 1, Shareholder 2, Shareholder 4, and Shareholder 5, as the case may be, will include the holding period of the Distributing stock surrendered by such shareholder in exchange therefor, provided the Distributing stock is held as a capital asset on the date of the Distributions (§ 1223(1)).

(11) As provided in § 312(h), proper allocation of earnings and profits among Distributing, Controlled A, and Controlled B will be made under § 1.312-10(a).

Caveats and Procedural Statements

No opinion is expressed about the tax treatment of the Proposed Transaction 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 Proposed Transaction that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each taxpayer involved in this transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the transaction covered by this letter is completed.

Under the power of attorney on file in this office, a copy of this letter is being sent to Distributing's authorized representative.

Sincerely,
Lewis K Brickates
Acting Chief, Branch 4
Office of Associate Chief Counsel
(Corporate)

cc: