

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:6-PLR-141108-02
Date:
October 1, 2002

Legend

- Distributing =
- Controlled Corporation #1 =
- Controlled Corporation #2 =
- Controlled Corporation #3 =
- Shareholder A =
- Shareholder B =
- Shareholder C =
- Shareholder D =
- Business 1 =
- Business 2 =
- Date 1 =
- a =
- State A =

Dear :

This letter responds to your June 25, 2002 request for rulings regarding certain federal income tax consequences of a proposed transaction. The information submitted in that

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request and in later correspondences dated August 19, 2002 and September 6, 2002 is summarized below.

Distributing was incorporated as a Subchapter "S" corporation in State A on Date 1. Distributing directly conducts Business 1 and Business 2.

Currently, Distributing has four shareholder family units. Shareholder A and his family, Shareholder B and his family, Shareholder C and his family and Shareholder D and his family each own an equal number of shares of Distributing, a %.

Shareholders A, B, C, and D actively participate in Business 1 and Business 2.

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.

Shareholders A, B, C, and D have different views as to the future operations of Business 1 and Business 2. Some of the problems which have resulted include, disagreements on management of corporate assets, and disagreements on decisions with respect to capital expenditures. To eliminate these differences, the following series of transactions are proposed:

- (i) Distributing would first redeem the a percent interest owned by Shareholder A and his family unit for cash
- (ii) Distributing would then form three subsidiaries (herein referred to as "Controlled Corporation #1", "Controlled Corporation #2" and "Controlled Corporation #3").
- (iii) Immediately thereafter, Distributing would contribute its remaining 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 B and his family unit in exchange for their interest in Distributing. Distributing will also distribute all of the stock of Controlled Corporation #2 to Shareholder C and his family unit in exchange for their interest in Distributing. Distributing will also distribute all of the stock of Controlled Corporation #3 to Shareholder D and his family unit in exchange for their interest in Distributing.
- (v) Distributing will be fully liquidated and will no longer exist after the proposed transaction.

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

- (a) The fair market value of Controlled corporation stock and other consideration received by each shareholder of Distributing approximately equals the fair market value of the Distributing stock surrendered by the shareholder in the exchange.
- (b) Following the transaction, each of the Controlled corporations will continue independently the activities of the business conducted by Distributing prior to the consummation of the transaction. Distributing, having retired all of its capital stock, will dissolve.
- (c) The total adjusted basis and fair market value of the assets transferred to each Controlled corporation by Distributing each equal or exceed the sum of the liabilities assumed by the Controlled corporation plus any liabilities to which the transferred assets are subject
- (d) The liabilities assumed 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.
- (e) No part of the consideration distributed by Distributing is being received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (f) No intercorporate debt will exist between Distributing and any Controlled corporation at the time of or subsequent to the distribution of the Controlled corporations stock.
- (g) No parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv) of the Code.
- (h) The five years of financial information submitted on behalf of Distributing is representative of that corporation's present operations and there have been no substantial operational changes since the date of the last financial statements submitted.
- (i) 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.

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- (j) 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.
- (k) There is no plan or intention by either Distributing or the Controlled corporations, directly or through a 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.
- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (m) Distributing is an S corporation (within the meaning of section 1361(a)). The Controlled corporations will elect to be S corporations pursuant to 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 elections of either the Distributing or Controlled corporations.
- (n) 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.
- (o) 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 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 Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date.
- (p) 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 Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled 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 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.
- (q) The distribution of the stock, or stock and securities, of the Controlled corporations is carried out for the following corporate business purpose: To

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resolve management problems associated with the operations of Business 1 and Business 2. Shareholders A, B, C, and D have different views as to the future operations of Business 1 and Business 2. Some of the problems which have resulted include, disagreements on management of corporate assets, and disagreements on decisions with respect to capital expenditures. The distribution of the stock, or stock and securities, of the Controlled Corporations is motivated by this business purpose.

- (r) The gross assets of the trades or businesses that will be relied upon by each Controlled corporation to satisfy the active trade or business requirement of § 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 trades or businesses.

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

1. The transfer by Distributing of all of its assets to the three Controlled corporations in exchange for all of their stock, followed by the distribution by Distributing of the stock of Controlled Corporation #1, Controlled Corporation #2 and Controlled Corporation #3 to Shareholder B and his family unit, Shareholder C and his family unit and Shareholder D and his family unit 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 each be “a party to the 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. section 361(a) and 357(a)).
3. No gain or loss will be recognized by the Controlled corporations on receipt of assets of Distributing in exchange for the stock of the Controlled corporations. (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)).

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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 the shareholders in exchange for all of the Distributing stock currently held by those shareholders. (I.R.C. section 361(c)(1)).
7. No gain or loss will be recognized by (and no amount will be includible in the income of) any of the shareholders upon the 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 of its shareholders will be the same as the basis of Distributing stock surrendered in 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 between Distributing and each Controlled corporation will be made under Treas. Reg. section 1.312-10(a).
11. Amounts received by Shareholder A and his family unit in the redemption described above will be treated as full payment in exchange for the Distributing stock surrendered (section 331(a)).
12. The momentary ownership, by Distributing, of stock in the newly formed Controlled corporations for the sole purpose of completing the proposed transaction will not terminate the Subchapter S election of Distributing under I.R.C. section 1362(d)(2)(A).
13. The Controlled corporations will be able to elect Subchapter S status under I.R.C. section 1362 immediately after the distribution has been completed to their stockholders.

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.

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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.

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.

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.

Pursuant to a power of attorney on file in this office, a copy of this letter is being sent to the taxpayer.

Sincerely yours,

Reginald Mombrun

Reginald Mombrun
Assistant Branch Chief, Branch 6
Office of Associate Chief Counsel
(Corporate)