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Department of the Treasury  
Washington, DC 20224

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Date:  
May 31, 2007

LEGEND:

Distributing =

Holding =

Controlled-1 =

Controlled-2 =

Controlled-3 =

Controlled-4 =

OtherSub1 =

OtherSub2 =

OtherSub3 =

OtherSub4 =

StateA =

Day1 =

Year1 =

DateA =

DateB =

DateC =

MainBusiness =

BusinessA =

BusinessB =

BusinessC =

BusinessD =

LocationA =

LocationB =  
LocationC =

ShareholderA =

Children =

UnrelatedShareholder =

e =

f =

v =

h =

k =

Dear :

This letter responds to your representative's letter, signed 26 January 2007, requesting rulings as to the Federal income tax consequences of a proposed transaction. The information submitted in that letter and subsequent correspondence is summarized below.

The rulings contained in this letter are based upon facts and representations that were submitted on behalf of the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding: (I) whether the distribution described below satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; or (II) whether this distribution is part of a plan (or a series of related transactions) pursuant to

which one or more persons will acquire directly or indirectly stock representing a fifty percent (50%) or greater interest in Distributing or any of the Controlled corporations (see § 355(e) of the Internal Revenue Code and § 1.355-7 of the regulations). Moreover, no opinion is expressed on the validity of any subchapter S election of either Distributing or any of the Controlled corporations.

## SUMMARY OF FACTS

Distributing is a closely held StateA corporation that uses the accrual method of accounting and a fiscal year ending on Day1 and has been an S corporation since Year1. Distributing is engaged in MainBusiness through its subsidiaries, especially OtherSub1, OtherSub2, OtherSub3, and OtherSub4 (the "OtherSubs"). Distributing has outstanding e shares of common stock (and no other stock), all of which stock is held by its shareholders (the "Shareholders"). This stock is held 90% by the ShareholderA Family (ShareholderA and the Children). The other 10 % is held by Unrelated Shareholder who acquired almost all of his stock more than a year ago by purchase ("Prior Stock Purchase").

Controlled-1, Controlled-2, Controlled-3, and Controlled-4 ("The Controlled") are each a StateA corporation that uses the accrual method of accounting and a Day1 fiscal year. Each of The Controlled is a wholly owned subsidiary of Distributing and is a Qualified Subchapter S Subsidiary [a QSub] pursuant to an election effective on DateB. Controlled-1, -2, -3, and -4 are engaged in BusinessA, BusinessB, BusinessC, and BusinessD, respectively. Controlled-4 conducts BusinessD at LocationA, LocationB, and LocationC. Immediately prior to the proposed transaction, each of The Controlled will have outstanding solely f shares of common stock.

Each of the OtherSubs is a StateA corporation, uses the accrual method of accounting, and has a Day1 fiscal year. Each of the OtherSubs is engaged in MainBusiness. Each of the OtherSubs is a wholly owned subsidiary of Distributing and (except for OtherSub4) is a QSub pursuant to an election effective DateB.

Management of Distributing has determined that the various businesses of Distributing and its subsidiaries would operate better if MainBusiness, BusinessA, BusinessB, BusinessC, and BusinessD were each operated in separate corporations. To achieve this separation, Distributing will engage in distributions (the "Distributions") in which it will distribute all the stock in each of The Controlled to the Shareholders.

The financial information submitted by Distributing indicates that Distributing's MainBusiness (which it conducts directly through its OtherSubs) has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years. Furthermore, this financial information also indicates that, at the time of the Distributions, Controlled-1, -2, -3, and -4 [or their predecessors] will

each have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the prior 5 years for BusinessA, BusinessB, BusinessC, and BusinessD, respectively.

## PRIOR TRANSACTIONS

**Previous Acquisitions of Holding Stock.** Over a year ago, in three transactions over a period of several years, Distributing acquired (via the "PreviousAcquisitions") a small percentage (approximately y %) of the stock in Holding by purchase for cash from ShareholderA.

**Recent Transactions.** In the year prior to the proposed transactions, in order to facilitate the proposed corporate separations, Distributing together with the Shareholders had already undertaken transactions involving Holding and The Controlled and OtherSubs. Prior to DateA, Distributing held over 80% but less than 100% of all the outstanding stock in Holding and Holding held all the outstanding stock in The Controlled and OtherSubs. On DateA, the ShareholderA Family contributed (via the "PriorStockTransfer") all the remaining stock in Holding (approximately h %) to Distributing in exchange solely for additional Distributing stock so that Holding became a wholly owned subsidiary of Distributing [taxpayer represents that this was a nonrecognition transaction pursuant to § 351(a)]. Thereafter, (via the "Prior Liquidation") Holding became a QSub effective DateB, and then was dissolved on DateC, resulting in Distributing directly owning The Controlled and the OtherSubs.

**Recapitalization.** Furthermore, in order to reduce the number of shares outstanding prior to the Distributions, each of The Controlled has or will undergo a recapitalization ("PriorRecap") in which Distributing will exchange all its stock in each of The Controlled (k shares) solely for a smaller number of shares in such Controlled (f shares).

## PROPOSED TRANSACTIONS: STOCK DISTRIBUTIONS AND S ELECTIONS

**Stock Distributions.** In the Distributions, Distributing will distribute to the Shareholders all of the outstanding stock in each of The Controlled (f shares of common). The distributions of the stock in The Controlled will be pro rata to each of the Shareholders and the Shareholders will not surrender any Distributing stock. Following the Distributions, the outstanding stock in each of the four Controlled will be held by the Shareholders in exactly the same percentages as they hold their stock in Distributing.

**Loss of QSub status.** In the Distributions, The Controlled will cease to be subsidiaries and will lose their status as QSubs.

S Elections. Following the Distributions, each of The Controlled will make an election under § 1362(a) to be treated as an S corporation (within the meaning of § 1361(a)).

## REPRESENTATIONS

Distributing has made the representations below. Representation (a), below, is made jointly by both Distributing and ShareholderA. Representations (b), (c) and (d), below, deal with the transfers of assets and liabilities from Distributing to The Controlled. These representations (b), (c), and (d) apply to the transfers of assets and assumptions of liabilities which occur as a result of the terminations of The Controlled's QSub status (i.e, as a result of the Distributions). For purposes of determining the applicable time to which representations (b), (c), and (d) apply, those transfers of assets to, and assumptions of liabilities by, The Controlled which result from the terminations of QSub status are viewed as occurring immediately prior to the Distributions.

(a) The three acquisitions of Holding stock in the PreviousAcquisitions were each governed by § 351(a) pursuant to § 304(a)(1). ShareholderA will file amended Federal income tax returns covering all three of the PreviousAcquisitions so that each of the three transactions (1 July 2003, 1 July 2004, and 1 July 2005) is treated as a § 304(a)(1) transaction on ShareholderA's tax returns. Each of these amended ShareholderA tax returns (amended to provide for proper § 304(a)(1) treatment) will be filed, and any tax due paid, at such a time and in such a manner so that the filing and payment will be fully effective, and neither the filing nor the payment of tax due will be barred, ineffective, or revocable, or affected by any statute of limitations cut-off date.

(b) With regard to each of Controlled-1, -2, -3, and -4, both (i) the total adjusted basis of the assets and (ii) the fair market value of the assets received from Distributing will each equal or exceed the sum of the liabilities (as determined under § 357(d)) assumed by such controlled corporation.

(c) With regard to each of Controlled-1, -2, -3, and -4, the liabilities of Distributing assumed by the controlled corporation (as determined under § 357(d)) and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets transferred.

(d) None of any of the transfers of assets from Distributing to The Controlled will constitute an "early disposition of investment credit property" within the meaning of § 50(a).

(e) Distributing, each of The Controlled, and each of the Shareholders will each pay his, her, or its own expenses incurred in connection with the Distributions.

(f) The Controlled have outstanding solely common stock.

(g) Prior to the Distributions, all the outstanding stock in each of The Controlled will be held by Distributing.

(h) Following the Distributions, all of the outstanding stock in each of The Controlled will be held by the Shareholders.

(i) None of The Controlled has, or is expected to have, any debt to the Shareholders, to another of The Controlled, to Distributing, or to any related entity.

(j) None of any debt that is or will be outstanding in any of The Controlled will constitute either stock or securities.

(k) There is no plan or intent to issue any stock in Distributing, or in any of The Controlled, in connection with or subsequent to the Distributions, except for (i) the stock in Distributing issued in the the PriorStockTransfer; and (ii) the stock in The Controlled issued to Distributing in the PriorRecap.

(l) Immediately prior to the Distributions, each share of the outstanding stock in Distributing will have been held by its then current holder at all times during the 5-year period prior to the Distributions, with the sole exceptions being: (i) the Distributing Stock (h percent of the Distributing stock now outstanding) received by the ShareholderA Family in the PriorStockTransfer, as described above; and (ii) the approximately 10 % of the Distributing Stock acquired by Unrelated Shareholder in the Prior Stock Purchase. With regard to each of the Distributions, the Distribution will not constitute a disqualified distribution within the meaning of § 355(d).

(m) At the time of the Distributions, none of The Controlled will have outstanding any warrants or options. In addition, at such time, there will be no plan or intention for any of The Controlled to issue any warrants, options, or debt.

(n) The Contribution and the Distributions are not related to, or connected to, or part of a plan involving any other transaction (except for the Prior Transactions and the loss of QSub status as described above). In the 5-year period prior to the Distributions, there will have been no changes in the holding of stock in Distributing or The Controlled, except as described above with regard to the Prior Transactions and the loss of QSub status. For each of the Controlled, It is anticipated that subsequent to the Distribution of such Controlled, all the outstanding stock in Distributing and all the outstanding stock in such Controlled will continue to be held by the Shareholders in the same manner as such stock is held immediately after the Distribution is consummated.

(o) Neither Distributing nor any of The Controlled is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).

(p) Each of the Controlled and OtherSubs will have been a wholly owned subsidiary of either Distributing or Holding (or a disregarded entity entirely held by either Distributing or Holding) throughout the 5-year pre-Distribution period.

(q) Prior to the liquidation of Holding, Distributing held all the outstanding stock in Holding throughout the 5-year pre-Distribution period, except for stock that was acquired from the ShareholderA Family, as described above under Prior Transactions. All the Holding stock acquired by Distributing during the 5-year pre-Distribution period was acquired in nonrecognition transfers to which § 355(a)(3)(B) does not apply.

(r) None of the Distributions is part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty percent (50%) or greater interest (within the meaning of § 355(d)(4)) in Distributing or any of The Controlled (including any predecessor or successor of any such corporation).

(s) No part of the stock in The Controlled is being received by a shareholder as a creditor, employee or in any capacity other than as a shareholder of Distributing.

(t) The five years of financial information submitted on behalf of each of the businesses (MainBusiness as operated by the OtherSubs, BusinessA, BusinessB, BusinessC, and BusinessD) is representative of the present operations of each business and, regarding each business, there have been no substantial operational changes since the date of the last financial statements submitted for such business.

(u) Following the Distributions, Distributing will continue to be directly engaged in the active conduct of MainBusiness independently and with its own separate employees including the employees of its OtherSubs [QSubs] (and through the actions of its own officers, directors, and/or shareholders acting on its behalf). MainBusiness will have been actively conducted (within the meaning of § 1.355-3(b)) by Distributing and/or its OtherSubs independently and through their own employees (and their officers, directors, and/or shareholders) at all times in the 5-year period prior to the Distributions. In each year of the 5-year pre-Distribution period, Distributing (including its OtherSubs) directly had over 50 employees who were engaged in MainBusiness. There is no intention to terminate the QSub status of the OtherSubs and it is expected that Distributing, including its QSubs, will continue to directly have over 50 employees engaged in MainBusiness subsequent to the Distributions.

(v) Following its Distribution, Controlled-1 will be directly engaged in the active conduct of BusinessA independently and with its own employees (and through the actions of its own officers, directors, and/or shareholders acting on its behalf). BusinessA will have been actively conducted (within the meaning of § 1.355-3(b)) by Controlled-1 [or by predecessor corporations from whom the business was acquired in nonrecognition transactions] independently and through its own employees (and its

officers, directors, and/or shareholders) at all times in the 5-year period prior to the Distribution.

(w) Following its Distribution, Controlled-2 will be directly engaged in the active conduct of BusinessB independently and with its own employees (and through the actions of its own officers, directors, and/or shareholders acting on its behalf). BusinessB will have been actively conducted (within the meaning of § 1.355-3(b)) by Controlled-2 [or by predecessor corporations from whom the business was acquired in nonrecognition transactions] independently and through its own employees (and its officers, directors, and/or shareholders) at all times in the 5-year period prior to the Distribution.

(x) Following its Distribution, Controlled-3 will be directly engaged in the active conduct of BusinessC independently and with its own employees (and through the actions of its own officers, directors, and/or shareholders acting on its behalf). BusinessC will have been actively conducted (within the meaning of § 1.355-3(b)) by Controlled-3 [or by predecessor corporations from whom the business was acquired in nonrecognition transactions] independently and through its own employees (and its officers, directors, and/or shareholders) at all times in the 5-year period prior to the Distribution.

(y) Following its Distribution, Controlled-4 will be directly engaged in the active conduct of BusinessD independently and with its own employees (and through the actions of its own officers, directors, and/or shareholders acting on its behalf). BusinessD will have been actively conducted (within the meaning of § 1.355-3(b)) by Controlled-4 [or by predecessor corporations from whom the business was acquired in nonrecognition transactions] independently and through its own employees (and its officers, directors, and/or shareholders) at all times in the 5-year period prior to the Distribution.

(z) The Distributions are being carried out for one or more corporate business purposes.

(aa) There is no plan or intention to liquidate either Distributing or any of The Controlled, to merge either Distributing or any of The Controlled with any other corporation, or to sell or otherwise dispose of the assets of either Distributing or The Controlled subsequent to the Distributions, except for dispositions of assets in the ordinary course of business. It is possible that, subsequent to the Distributions, Distributing or MainBusiness could be acquired; however, as of the time the Distributions are consummated, there will be no plan, agreement or negotiations with regard thereto.

(bb) There is no plan or commitment by any of the Shareholders to sell, exchange, transfer by gift, have redeemed or otherwise dispose of any of their stock in Distributing or of any of their stock in any of The Controlled.

(cc) Distributing presently has no current or accumulated earnings and profits, and at the time the Distributions are consummated neither Distributing nor any of The Controlled will have any current or accumulated earnings and profits. None of the Distributions will be used principally as a device for the distribution of earnings and profits of either Distributing or The Controlled.

(dd) The Distributions are not intended to, or expected to, result in a reduction in the total amount of Federal income tax payable by Distributing and its successors. That is, the total amount of Federal income tax payable after the Distributions by Distributing and The Controlled is anticipated to be no less than the amount that would be payable by Distributing if the Distributions did not occur.

(ee) With regard to each of the Distributions, after the Distribution is consummated, any transactions that occur between Distributing (including Distributing related entities) and The Controlled, or among The Controlled, will occur in the ordinary course of business and will be negotiated at arm's length and for fair market value.

(ff) There is no plan or intention by either Distributing or any of The Controlled, directly or through any subsidiary or related entity, to purchase any of its outstanding stock after the Distributions, other than through stock purchases meeting the requirements of Section 4.05(1)(b) of Rev. Proc. 96-30.

(gg) Distributing is an S corporation (within the meaning of § 1361(a)). Each of The Controlled will elect to be an S corporation pursuant to § 1362(a) immediately after its Distribution and there is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or any of The Controlled.

(hh) Neither Distributing nor any of The Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).

(ii) None of the persons holding stock or any equity interest in either Distributing or any of the Controlled is a nonresident alien individual or a foreign corporation. [Or, alternatively, neither Distributing nor any of The Controlled has been or will be a United States real property holding corporation ("USRPHC"), as defined in § 897(c)(2), at any time during the 5-year period ending on the date of its Distribution and neither Distributing nor any of The Controlled will be a USRPHC immediately after the Distributions.]

Section 1361(a)(1) provides that the term "S corporation" means, with respect to a taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(b)(3)(A) provides that (i) a corporation which is a QSub shall not be treated as a separate corporation and (ii) all assets, liabilities, and items of income, deduction and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that the term "qualified subchapter S subsidiary" means any domestic corporation which is not an ineligible corporation if (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

Section 1361(b)(3)(C) provides that if any corporation which was a QSub ceases to meet the requirements of § 1361(b)(3)(B), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the S corporation in exchange for its stock.

Section 1361(b)(3)(D) provides that if a corporation's status as a QSub terminates, such corporation (and any successor corporation) shall not be eligible to make (i) an election to be treated as a QSub or (ii) an election to be treated as an S corporation, before its 5th taxable year which begins after the first taxable year for which such termination was effective, unless the Secretary consents to such election.

Section 1.1361-4(a)(2)(i) provides that if an S corporation makes a valid QSub election with respect to a subsidiary, the subsidiary is deemed to have liquidated into the S corporation.

Section 1.1361-5(b)(1)(i) provides that if a QSub election terminates, the former QSub is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the termination from the S corporation parent in exchange for the stock of the new corporation. The tax treatment of this transaction or of a larger transaction that includes this transaction will be determined under the Code and general principles of tax law, including the step transaction doctrine.

Section 1.1361-5(b)(3) Example 4 provides an example whereby an S corporation that distributes the stock of its QSub to its shareholders, terminating the QSub election, can qualify as a distribution to which §§ 368(a)(1)(D) and 355 apply if the transaction otherwise satisfies the requirements of those sections.

Section 1.1361-5(c)(2) provides that a corporation may make an S election or have a QSub election made with respect to it before the expiration of the five-year period described in § 1361(b)(3)(D) provided that (i) immediately following the termination, the corporation (or its successor corporation) is otherwise eligible to make an S election or have a QSub election made for it; and (ii) the relevant election is made effective immediately following the termination of the QSub election.

## RULINGS

Based solely on the information submitted and the representations set forth above, and provided that each of the three Previous Acquisitions of Holding Stock by Distributing is treated as if all such Holding stock was acquired in a § 351(a) transaction pursuant to § 304(a)(1), we rule as follows:

(1) Distributing's distribution of all of the stock in The Controlled's to the Shareholders in the Distributions will cause a termination of the The Controlled's QSub elections because they will cease to be wholly owned subsidiaries of an S corporation. As a result, Controlled-1, -2, -3, and -4 will each be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) in a contribution (the "Contribution") from, and transfer from, Distributing, occurring immediately before the termination of such Controlled's QSub status, with Distributing receiving in exchange all the stock of Controlled-1, -2, -3, and -4 respectively. (Section 1.1361-5(b)(1)(i)).

(2) For each of The Controlled's, the Contribution (resulting from the termination of such Controlled's QSub status as described in ruling (1) above) followed by its Distribution will be a reorganization within the meaning of § 368(a)(1)(D). For each of these four "D" reorganizations, Distributing and the applicable Controlled will each be a "party to a reorganization" within the meaning of § 368(b).

(3) In each reorganization, no gain or loss will be recognized by Distributing upon the transfer of assets to the applicable Controlled in exchange for stock in such Controlled and the assumption of Distributing liabilities by such Controlled (as specified in representations (b), (c) and (d) above) in conjunction with the Contribution (§§ 361(a) and 357(a)).

(4) For each of The Controlled's, no gain or loss will be recognized by such Controlled on the receipt of Distributing assets in exchange for stock in such Controlled (§ 1032(a)).

(5) The basis of each asset received by a Controlled will be determined in accordance with § 362(b) and § 362(e).

(6) The holding period for each of the assets received by a Controlled will include the period during which such asset was held by Distributing (§ 1223(2)).

(7) No gain or loss will be recognized by Distributing upon the distributions to the Shareholders of stock in The Controlled in the Distributions, as described above (§ 361(c)(1)).

(8) No gain or loss will be recognized by (and no amount will be included in the income of) the Shareholders upon receipt of stock in The Controlled in the Distributions (§ 355(a)(1)).

(9) For each of the Shareholders, immediately after the Distributions, the Shareholder's total bases in all the stock held [that is, the total of (i) the basis of all the stock received by such Shareholder in all of The Controlled plus (ii) the basis of the stock in Distributing held by such Shareholder] will be the same as the basis of the Distributing stock held by such Shareholder immediately prior to the Distributions (§ 358(a)(1)). For each Shareholder, the Shareholder's total basis will be allocated among the stock of Distributing and the stock in each of The Controlled in proportion to the relative fair market values of such stock in accordance with § 1.358-2(a)(2).

(10) For each of the Shareholders, the holding period of the stock received in The Controlled will include the holding period of the Distributing stock with respect to which it is received, provided that the Distributing stock is held as a capital asset in the hands of the Shareholder on the date of the exchange (§ 1223(1)).

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

(12) Distributing's momentary ownership of the stock of Controlled-1, -2, -3, and -4, as part of the reorganizations under § 368(a)(1)(D), will not cause Controlled-1, -2, -3, or -4 to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If Controlled-1, -2, -3, and -4 otherwise meet the requirements of a small business corporation under § 1361, each will be eligible to make a subchapter S election under § 1362(a) for its first taxable year, provided such election is made effective immediately following the termination of Controlled-1, -2, -3, and -4's respective QSub elections.

(13) Each of The Controlled that becomes an S corporation will become subject to the built-in gain provisions of § 1374. For purposes of § 1374, the 10-year recognition period specified in § 1374(d)(7) for each of The Controlled will begin on the same date as it would have begun for Distributing if the Distributions had not occurred.

#### CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any matter or item discussed or referenced in this letter. Moreover, no opinion is expressed about the tax treatment of

the Distributions [or of any other matter] 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 Distributions not specifically covered by the above rulings. In particular (as provided above), no opinion is expressed regarding: (I) whether each of the Distributions satisfies the business purpose requirement of § 1.355-2(b); and (II) whether any of the Distributions is part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii). Furthermore, no opinion is expressed about the tax treatment of any of the Prior Transactions [page 5, above]. Finally, no opinion is expressed as to the validity of any subchapter S election.

#### PROCEDURAL STATEMENTS

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

It is important that a copy of this letter be attached to the Federal income tax returns of each taxpayer involved for the taxable year in which the Distributions are consummated. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching to the return a statement that provides the date and control number (PLR-105708-07) of this ruling letter.

Pursuant to the power of attorney on file in this matter, a copy of this letter is being sent to your authorized representative.

Sincerely,

*Douglas C. Bates*  
Douglas C. Bates  
Assistant to the Branch Chief, Branch 5  
Office of Associate Chief Counsel  
(Corporate)