

Internal Revenue Service

Number: **200826030**

Release Date: 6/27/2008

Index Number: 368.04-00, 355.01-01

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:01

PLR-151320-07

Date:

March 19, 2008

LEGEND:

Distributing =

Controlled =

State X =

Date 1 =

Date 2 =

Group A Shareholders =

Group B Shareholders =

X =

Y =

Business 1: =

Business 2: =

Business 2 Assets =

Dear :

This letter responds to your representative's letter dated November 13, 2007, requesting rulings as to the Federal income tax consequences of a proposed transaction. Additional information was submitted by letters dated February 11, 2008, February 15, 2008 and March 4, 2008. The material information submitted for consideration is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials 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, whether the proposed transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code (the "Code") and § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e) and § 1.355-7).

SUMMARY OF FACTS

Distributing is a closely held State X corporation that was organized as a subchapter C corporation on Date 1. Distributing made an S corporation election on Date 2 (more

than ten years ago). Distributing is owned by two family shareholder groups. The Group A Shareholders together own $x\%$ and the Group B Shareholders together own $y\%$ of the stock of Distributing.

Distributing is engaged in Business 1 and Business 2. Distributing has submitted financial information which indicates that Business 1 and Business 2 have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

PROPOSED TRANSACTION

For what are represented as valid business reasons, Distributing proposes the following transactions (the "Proposed Transaction"):

- (i) Controlled will be incorporated by Distributing in State X. Controlled will have one class of common stock outstanding, all of which will be owned by Distributing.
- (ii) Distributing will transfer certain Business 2 Assets and liabilities, proportional amounts of other investments (and in the event asset values need to be balanced, cash) to Controlled in exchange for Controlled stock (the "Contribution").
- (iii) Immediately after the Contribution, Distributing will distribute all of the Controlled stock to the Group B Shareholders in exchange for all of their Distributing stock (the "Distribution"). Thereafter, the Group A Shareholders will own all of the Distributing stock and the Group B Shareholders will own all of the Controlled stock.
- (iv) Steps (i) through (iii) will all occur on the same date.
- (v) Immediately following the Proposed Transaction, Controlled will make an S corporation election.

REPRESENTATIONS

The following representations have been made with respect to the Proposed Transaction:

- (a) The fair market value of the Controlled stock to be received by the Group B Shareholders will be approximately equal to the fair market value of the Distributing stock surrendered by the Group B Shareholders in the exchange.

- (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 of a Distributing shareholder.
- (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.
- (d) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (e) The Distribution is carried out for the following corporate business purposes: to alleviate the fundamental differences of opinion among the significant shareholders regarding business strategies and philosophies in the two lines of business; to create credit and other working capital advantages which will generate enhanced profitability; and to provide asset protection, insulating each separate business from the claims of creditors of the other line of business. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (g) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing will each equal or exceed the sum of the liabilities assumed (as determined under § 357(d)) by Controlled plus any liabilities to which the transferred assets are subject; and the liabilities assumed (as determined under § 357(d)) 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.
- (h) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (i) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to the Distribution.
- (j) 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.

- (k) No two parties to the transaction are investment companies as defined in §§ 368(a)(2)(F)(iii) and (iv).
- (l) The Distribution is not 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 or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (m) Distributing is an S corporation (within the meaning of § 1361(a)). Immediately following the Proposed Transaction, Controlled will elect to be an S corporation pursuant to § 1362(a). There is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.
- (n) On the date of the Proposed Transaction, Distributing will have no assets subject to § 1374.

RULINGS

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

- (1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for Controlled stock and the assumption by Controlled of liabilities of Distributing in the Contribution. Sections 361(a) and 357(a).
- (3) No gain or loss will be recognized by Controlled on the Contribution. Section 1032(a).
- (4) The basis of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately prior to its transfer. Section 362(b).
- (5) The holding period for each asset received by Controlled from Distributing will include the period during which Distributing held the asset. Section 1223(2).

- (6) No gain or loss will be recognized by Distributing on the Distribution. Section 361(c).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Group B Shareholders upon their receipt of Controlled stock in exchange for their Distributing stock. Sections 355(a).
- (8) The basis of the Controlled stock in the hands of the Group B Shareholders after the Distribution will, in each instance, equal the basis of the respective Distributing stock surrendered by the shareholder in exchange therefore. Section 358(a)(1).
- (9) The holding period of the Controlled stock received by the Group B Shareholders will, in each instance, include the holding period of the respective Distributing stock surrendered by the shareholder, provided such stock is held as a capital asset on the date of the Distribution. Section 1223(1).
- (10) Proper allocation of Distributing's earnings and profits will be made under §§ 312(h) and 1.312-10(a).
- (11) Distributing's accumulated adjustments account immediately before the transaction will be allocated among Distributing and Controlled in a manner similar to the manner in which Distributing's earnings and profits will be allocated under §§ 312(h) (see §§ 1.312-10(a) and 1.1368-2(d)(3)).
- (12) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under § 1361, Controlled will be eligible to elect to be a subchapter S corporation under § 1362(a) for its first taxable year.

CAVEATS

No opinion is expressed about the tax treatment of the Proposed Transaction described above under other provisions of the Code and regulations or the tax treatment of any condition existing at the time of, or effects resulting from, the Proposed Transaction that is not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the Proposed Transaction satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Proposed Transaction is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see § 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Proposed Transaction is part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii).

PROCEDURAL STATEMENTS

This ruling letter 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 letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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,

Michael J. Wilder
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel (Corporate)