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LEGEND

Distributing =

Controlled =

Corp XYZ =

PRS-1 =

PRS-2 =

PRS-3 =

PRS-4 =

PRS-5 =

LLC-1 =

LLC-2 =

Shareholder AA =

Shareholder BB =

Shareholder CC =

Asset 1 =

Asset 2 =

Asset 3 =

Asset 4 =

Asset 5 =

Asset 6 =

Asset 7 =

Asset 8 =

Asset 9 =

Asset 10 =

Asset 11 =

Asset 12 =

Asset 13 =

Asset 14 =

Asset 15 =

Asset 16 =  
Date 1 =

Date 2 =

Date 3 =

Date 4 =

#a =

#b =

#c =

#d =

#e =

#f =

\$gg =

a% =

b% =

c% =

d% =

e% =

f% =

g% =

h% =

i% =

j% =

k% =  
l% =  
m% =  
n% =  
o% =  
p% =  
q% =  
r% =  
s% =  
t% =  
X business =  
State A =

Dear \_\_\_\_\_ :

This letter responds to your May 7, 2008, letter requesting rulings on certain federal income tax consequences of the Proposed Transaction (described below). The information provided in that letter and in later correspondence is summarized below.

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. 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.

Moreover, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Distribution (described below): satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (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 section 355(a)(1)(B) of the Internal Revenue Code (the "Code") and Treas. Reg. § 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 50-percent or

greater interest in the distributing corporation or the controlled corporation (see section 355(e)(2)(a)(ii) and Treas. Reg. § 1.355-7).

## FACTS

Distributing was formed on Date 1 in State A. Distributing is an S corporation. Shareholder AA owns #a shares of Distributing Class A common voting stock and #b shares of Distributing Class B non-voting common stock. Shareholder BB owns #a shares of Distributing Class A common voting stock and #c shares of Distributing Class B non-voting common stock. Shareholder CC owns #d shares of Distributing Class B non-voting common stock. Shareholder AA and Shareholder BB are officers of Distributing.

Distributing has been engaged in X business since Date 1. Distributing owns Assets 1-7. These assets are X business assets. In addition, Distributing owns other X business assets. Distributing itself has no operational employees. Shareholder AA and Shareholder BB make all of the significant business decisions with respect to Distributing's X business.

Corp XYZ was formed on Date 2 in State A. Corp XYZ is an S corporation. Shareholder AA owns #e shares of Corp XYZ Class A voting common stock and #f shares of Corp XYZ, Class B, non-voting common stock. Shareholder BB owns #e shares of Corp XYZ, Class A, voting common stock and #f shares of Corp XYZ, Class B, non-voting common stock. Corp XYZ owns a% of X Business' Asset 13. Shareholder AA and Shareholder BB are officers of Corp XYZ.

PRS-1 is a domestic limited partnership formed on Date 3. Shareholder AA and Shareholder BB are the general partners of PRS-1. For the past five years, Shareholder AA has had a profits interest in PRS-1 of not more than b%. For the past five years, Shareholder BB has had a profits interest in PRS-1 of not more than b%. Distributing is a limited partner of PRS-1. Distributing acquired its limited partnership interest in PRS-1 on Date 4. During the past five years, Distributing had a profits interest in PRS-1 of not less than c%. During the past five years, Distributing had a capital interest in PRS-1 of d%.

PRS-1 owns X business' Assets 8-12 and Asset 16 and e% of X business' Asset 13. In addition, PRS-1 owns the land and building which serves as the central office for the entities, herein described.

PRS-1 provides some of its employees to Distributing's X business. These employees perform services for Distributing for an arm's length price. These employees provide both management and operational functions for Distributing's X business. PRS-1 is responsible for both hiring and training these employees. Distributing through its officers (Shareholder AA and Shareholder BB) has performed active and substantial management functions for PRS-1.

Distributing through its officers (Shareholder AA and Shareholder BB) make significant business decisions regarding significant business issues of PRS-1. In addition, Shareholder AA and Shareholder BB participate in the overall supervision, and direction, and control of the employees of PRS-1 performing operational and management functions for Distributing. In addition, Shareholder AA and Shareholder BB participate in the overall supervision, and direction, and control of the remaining employees of PRS-1 who perform operational and management functions for other entities. PRS-1 currently owes Distributing \$gg (“The Intercompany Note”).

LLC 1 is a domestic limited liability company that has been classified as a partnership for federal income tax purposes. The members of LLC 1 are PRS-2 and PRS-3. PRS-2 and PRS-3 each own a f% capital and profits interest in LLC 1. LLC-1 owns X business’ Asset 14.

LLC 2 is a domestic limited liability company that has been classified as a partnership for federal income tax purposes. The members of LLC 2 are PRS-2 and PRS-3. PRS-2 and PRS-3 each own a f% capital and profits interest in LLC 2. LLC 2 owns X business Asset 15.

PRS-2 is a domestic limited partnership. Shareholder AA and Shareholder AA’s spouse are the general partners of PRS-2. Shareholder AA and Shareholder AA’s spouse each own a g% capital and profits interest in PRS-2. Shareholder AA’s children are the limited partners of PRS-2. Shareholder AA’s children each own a h% capital and profits interest in PRS-2.

PRS-3 is a domestic limited partnership. Shareholder BB is the general partner of PRS-3. Shareholder BB and Shareholder CC are the limited partners of PRS-3. Shareholder CC owns a i% capital and profits interest in PRS-3. Shareholder BB owns a j% capital and profits interest in PRS-3.

Financial information has been received indicating that X Business has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

For what are represented as constituting valid business reasons, Distributing has proposed the following transaction:

### **PROPOSED TRANSACTION**

- (1) Corp XYZ will be merged into Distributing pursuant to § 368(a)(1) with Distributing as the surviving corporation.
- (2) PRS-1 will distribute Asset 16 and an e% interest in Asset 13 to Shareholder AA and Shareholder BB.
- (3) Shareholders AA and BB will transfer Asset 16 and an e% interest of

Asset 13 to Distributing as contributions to capital.

- (4) Distributing will transfer k% of Asset 7 to PRS-1 in exchange for Assets 8 and 10.
- (5) Distributing will form Controlled and will transfer the following assets (subject to liabilities): Asset 2, Asset 4, Asset 5, l% of Asset 7, Asset 13, f% of its interest in PRS-1 and f% of its other assets (thus excluding Asset 1, Asset 3, Asset 6, Asset 8 and Asset 10 and its f% interest in PRS-1) to Controlled in exchange for all of Controlled's stock ("The Contribution"). Distributing will assign f% of the Intercompany Note to Controlled. After the completion of the above mentioned transaction, the value of X Business held by Distributing and Controlled will be approximately the same.
- (6) Distributing will distribute all of the stock of Controlled to Shareholder AA in exchange for all of Shareholder AA's stock in Distributing. ("The Distribution").
- (7) Controlled will elect to be an S corporation.
- (8) PRS-2 and PRS-3 will be merged into PRS-1. LLC-1 and LLC-2 will be liquidated and their assets subject to liabilities will be distributed to PRS-1.
- (9) Shareholder BB and Shareholder CC and Distributing will form PRS-4. PRS-1 will transfer Assets 9, 11 and 14, and other assets (subject to mortgages and other related liabilities including f% of the Intercompany Note) to Shareholder BB, Shareholder CC and Distributing. Shareholder BB, Shareholder CC and Distributing will then contribute the above-mentioned assets and related liabilities to PRS-4. Distributing will own approximately an m% capital and profits in PRS-4. Shareholder BB will own approximately a n% capital and profits interest in PRS-4. Shareholder CC will own approximately an o% capital and profits interest in PRS-4.
- (10) Shareholder AA, Shareholder AA's spouse and Shareholder AA's children and Controlled will form PRS-5. PRS-1 will transfer Asset 12, 15 and k% of Asset 7 and other assets (subject to mortgages and related liabilities including f% of the Intercompany Note) to Shareholder AA, Shareholder AA's spouse, Shareholder AA's children and Controlled. Shareholder AA, Shareholder AA's spouse, Shareholder AA's children and Controlled will then contribute the above-mentioned assets and liabilities to PRS-5. Controlled will then receive approximately an m% capital and profits interest in PRS-5. Shareholder AA will receive approximately a p% profits and capital interest in PRS-5. Shareholder AA's spouse will receive approximately a q% capital and profits interest in PRS-5. Each of Shareholder AA's children will receive approximately an r% profits and capital interest in PRS-5.
- (11) PRS-1 will retain management assets (including all associated employees) and the Central office. PRS-1 will be converted to a general partnership with Shareholder AA,

Shareholder BB, Distributing and Controlled as general partners.  
Distributing will own approximately an s% capital and profits interest in PRS-1.  
Controlled will own a approximately an s% capital and profits interest in PRS-1.  
Shareholder AA will own approximately a t% capital and profits interest in PRS-1.  
Shareholder BB will own approximately a t% capital and profits interest in PRS-1.

After the Proposed Transaction, PRS-1 (through its employees) will provide management and operational services for X businesses of Distributing and Controlled. PRS-1 will provide employees to Distributing for an arm's length fee. PRS-1 will provide employees to Controlled for an arm's length fee. Distributing through its officer (Shareholder BB) will continue to perform active and substantial management functions for PRS-1. Distributing through its officer (Shareholder BB) will continue to make significant business decisions regarding the significant business issues of PRS-1. In addition, Shareholder BB will continue to participate in the overall supervision, direction, and control of the employees of PRS-1 performing operational and management functions for Distributing. Shareholder BB will make the significant business decisions for Distributing.

Controlled through its officer, (Shareholder AA), will perform active and substantial management functions for PRS-1. Controlled through its officer, (Shareholder AA), will make significant business decisions regarding significant business issues of PRS-1. In addition, Shareholder AA will continue to participate in the overall supervision, and direction, and control of the employees of PRS-1 performing operational and management functions for Controlled. Shareholder AA will make the significant business decisions for Controlled.

All of the employees of PRS-1 will continue as employees of PRS-1 after the Proposed transaction. Shareholder AA and Shareholder BB will continue to guarantee certain debts of PRS-1 after the Proposed Transaction.

- (12) Distributing, PRS-4 and Shareholder BB will enter into an indemnification agreement in which they agree to indemnify Controlled, PRS-5 and Shareholder AA for any liabilities on any debts retained by Distributing or assumed by PRS-4. Controlled, PRS-5 and Shareholder AA will enter into an indemnification agreement in which they agree to indemnify Distributing, PRS-4 and Shareholder BB for any liability on any debts assumed by Controlled or PRS-5.

## **REPRESENTATIONS**

The following representations are made with respect to the Distribution:

- (a) The fair market value of the controlled corporation stock and other consideration to be received by Shareholder AA of the distributing corporation will be approximately

equal to the fair market value of the distributing corporation stock surrendered by Shareholder AA in the exchange.

- (b) No part of the consideration to be distributed by the distributing corporation will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The five years of financial information submitted on behalf of the distributing corporation 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) The five years of financial information submitted on behalf of the business contributed to Controlled 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.
- (e) Following the transaction, the distributing and controlled corporation will each continue, independently and with its separate employees, (such employees will be provided by PRS 1 to Distributing and Controlled for an arms length price) the active conduct of its share of all the integrated activities of the business conducted by the distributing corporation prior to the consummation of the transaction.
- (f) The distribution of the stock, or stock and securities, of the controlled corporation is carried out for the following corporate business purpose: In order to resolve divergent shareholder interests and disputes. The distribution of the stock, or stock and securities, of the controlled corporation is motivated, in whole or substantial part, by this corporate business purpose.
- (g) The transaction is not 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).
- (h) The total adjusted basis and the fair market value of the assets transferred to Controlled in the Contribution will equal or exceed the sum of (i) the total liabilities assumed (within the meaning of § 357(d)) by Controlled, and (ii) the total amount of any money and the fair market value of any other property (within the meaning of § 361(b)) received by Distributing and transferred to its creditors in connection with the reorganization.
- (i) The liabilities assumed (within the meaning of § 357(d)) by Controlled in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.

- (j) The total fair market value of the assets transferred to Controlled in the Contribution will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing in connection with the exchange.
- (k) The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
- (l) The aggregate fair market value of the assets transferred to Controlled in the Contribution will equal or exceed the aggregate adjusted basis of these assets.
- (m) 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.
- (n) The distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (o) No intercorporate debt will exist between the distributing corporation and the controlled corporation at the time of, or subsequent to, the distribution of the controlled stock.
- (p) For purposes of § 355(d), immediately after the Distribution, 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 Distribution.
- (q) For purposes of § 355(d), immediately after the Distribution, 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 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 § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock or securities that were 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 Distribution.

- (r) Payments made in connection with all continuing transactions, if any, between the distributing and controlled corporations, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (s) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (t) 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 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (u) Immediately after the Distribution, neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).

#### **OTHER REPRESENTATIONS**

- (v) The Merger of Corp XYZ into Distributing will qualify as a tax-free reorganization under § 368(a)(1).
- (w) Controlled and PRS-5 will be solely responsible for the debts assumed by Controlled and PRS-5. Shareholder AA, Controlled and PRS-5 will indemnify Shareholder BB, Distributing and PRS-4 for any liability on the debts assumed by Controlled and PRS-5.
- (x) Distributing and PRS-4 will be solely responsible for the debts retained by Distributing or assumed by PRS-4. Shareholder BB, Distributing and PRS-4 will indemnify Shareholder AA, Controlled and PRS-5 for any liability on the debts retained by Distributing or assumed by PRS-4.

#### **RULINGS**

Based solely on the information and representations submitted, we rule as follows on the proposed transaction:

- (1) The transfer by Distributing to Controlled of assets in exchange for all of the outstanding stock of Controlled and Controlled's assumption of Distributing's liabilities, followed by Distributing's distribution of the Controlled stock to Shareholder AA in exchange for all of Shareholder AA's stock in Distributing, will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under § 368(b). See Rev. Rul. 77-11, 1977-1 C.B.

- (2) Distributing will not recognize any gain or loss on its transfer of property to Controlled in exchange for Controlled stock and Controlled's assumption of liabilities (§ 361(a) and § 357(a)).
- (3) Controlled will not recognize any gain or loss on the receipt of assets from Distributing in exchange for Controlled stock (§ 1032(a)).
- (4) Controlled's basis in each asset received from Distributing, will be the same as the basis of that asset in the hands of Distributing immediately before its transfer 362(b)).
- (5) Controlled's holding period in each asset received from Distributing, will include the period during which Distributing held that asset (§ 1223(2)).
- (6) Distributing will not recognize any gain or loss on the distribution of all the Controlled stock to Shareholder AA in exchange for all of Shareholder AA's Distributing stock (§ 361(c)).
- (7) Shareholder AA will not recognize any gain or loss (and will not otherwise include any amount in income) on the receipt of all of the shares of Controlled stock in exchange for all of its Distributing stock (§ 355(a)(1)).
- (8) The basis of the Controlled stock in the hands of Shareholder AA immediately after the exchange will be the same as that shareholder's basis in the Distributing stock held immediately before the exchange (§ 358(a)(1)).
- (9) The holding period of the Controlled stock received by Shareholder AA will include the holding period of the Distributing stock exchanged therefor, provided the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) Earnings and profits, if any, will be allocated between Distributing and Controlled in accordance with §§ 312(h) and 1.312-10(a).

### **CAVEATS**

We express no opinion about the tax treatment of the Proposed Transaction 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 are not specifically covered by the above rulings. In particular, no opinion is expressed regarding;

- (i) Whether the Distribution satisfies the business purpose requirement of Treas.Reg. § 1.355-2(b);

- (ii) Whether the Distribution is being used principally as a device for the distribution of earnings and profits of Distributing or the controlled corporation. (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d));
- (iii) Whether the Distribution 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 50-percent or greater interest in Distributing or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7).
- (iv) Whether the merger of Corp XYZ into Distributing qualifies as a reorganization under § 368(a)(1).

### **PROCEDURAL STATEMENTS**

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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 this letter ruling.

Sincerely,

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Steven J. Hankin  
Senior Technician Reviewer, Branch 6  
Office of Associate Chief Counsel (Corporate)