

## Internal Revenue Service

## Department of the Treasury

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CC:CORP:B06 PLR-152331-01  
Date:  
January 11, 2002

Re:  
EIN:

### Legend:

Distributing	=
Controlled	=
State	=
Business	=
Date 1	=
Date 2	=
Date 3	=
a	=
b	=
c	=
Year 19xx	=
Shareholder A	=
Shareholder B	=
Shareholder C	=
Shareholder D	=
Shareholder E	=
Shareholder F	=
Shareholder G	=
Shareholder H	=
Shareholder I	=
Shareholder J	=
aa	=
bb	=
cc	=

dd	=
ee	=
ff	=
gg	=
hh	=
ii	=
jj	=
kk	=
ll	=
mm	=
nn	=

Dear :

This is in response to the letter, dated September 20, 2001, in which Distributing, Controlled, Shareholder C and Shareholder H (collectively, the "Taxpayers"), request rulings regarding the federal income tax consequences of a proposed transaction. The information submitted for consideration is summarized below.

Distributing, a Subchapter S corporation, was organized as a Subchapter C corporation in State on Date 1. Distributing is engaged directly in managing and operating Business restaurants and has been so engaged since its formation. Distributing currently operates *a* restaurants. Distributing acquired *b* restaurants in Year 19xx, *c* of which (the "Acquired Stores") continue to be operated by Distributing. Distributing's only subsidiary is Controlled. Distributing uses the accrual method of accounting and has a 52-53 week fiscal taxable year ending on the last Sunday of the year.

Distributing's capital structure consists of two classes of stock: Voting Stock and Non-voting Stock. Collectively, Distributing's Voting Stock and Non-Voting Stock are referred to herein as the "Distributing Stock." Distributing's stock is not publically traded and it has no foreign shareholders.

Shareholders A, B, C and D (collectively, the "Voting Shareholders") own aa%, bb%, cc% and dd% of Distributing's Voting Stock, respectively. Together, they own 100% of Distributing's Voting Stock. Shareholders A, B and C are the only members of Distributing's Board of Directors. Shareholders A, B, C, D, E, F, G, H, I, and J (collectively, the "Nonvoting Shareholders") own ee%, ff%, gg%, hh%, ii%, jj%, kk%, ll%, mm%, and nn% of Distributing's Nonvoting Stock, respectively. Together, they own 100% of Distributing's Non-voting Stock. Distributing has no outstanding securities or other interests (such as bonds, debentures, notes, warrants, options, puts, etc.).

Controlled is a newly formed Subchapter C corporation. It was incorporated in State on Date 2. Controlled has substantially no assets and has not as yet commenced business.

Controlled's capital structure consists of two classes of stock: Voting Stock and Non-voting Stock. Collectively, the Controlled Voting Stock and Controlled Non-Voting Stock are referred to herein as the "Controlled Stock." Controlled has no outstanding securities or other interests (such as bonds, debentures, notes, warrants, options, puts, etc.). It is wholly-owned by Distributing. Distributing and Controlled do not join in the filing of a consolidated return.

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

A separation of Distributing is proposed to resolve irreconcilable shareholder disagreements over the management and direction of Distributing, specifically with regard to the Acquired Stores. Shareholders A and B, who collectively own a majority of Distributing's Voting Stock and represent two-thirds of the members of the Board of Directors, believe that the Acquired Stores should be sold. Shareholder C, who is a significant minority shareholder and represents one-third of the members of the Board of Directors, believes that Distributing should invest time, effort and financial resources in the Acquired Stores. Shareholder C desires to make such an investment personally, if Distributing will not do so.

This dispute between the Voting Shareholders is fundamental and unbridgeable. The Board of Directors has temporarily segregated the Acquired Stores into their own Division; however, this has not resolved the conflict between Shareholders A and B on the one hand, and Shareholder C on the other. The Board of Directors has decided to permanently resolve the conflict by dividing the assets of Distributing, dropping the Acquired Stores (including all property associated with the Acquired Stores) into Controlled, and distributing all of the stock of Controlled to Shareholders C and H in exchange for all Distributing Stock presently held by Shareholders C and H. It is intended that this be a parting of ways. The operation of the Acquired Stores independently of the Retained Stores will allow both Distributing and Controlled to operate without management strife or conflict and, thus, more efficiently and effectively. It is intended that, after the distribution, Shareholders C and H will own 100 percent of the outstanding stock of Controlled and Distributing will be owned by the remaining shareholders.

Accordingly, Distributing proposes the following transaction:

- (i) Distributing will transfer the Acquired Stores and the assets associated with the Acquired Stores from the Division to

Controlled in exchange for all of the stock of Controlled and the assumption by Controlled of related liabilities (the "Contribution").

- (ii) Distributing will distribute the stock of Controlled to Shareholders C and H in exchange for all of their stock in Distributing (the "Distribution").

(Together, Contribution and Distribution will be referred to hereafter as the "Transaction.") After the Distribution, both Distributing and Controlled will use the accrual method and both will have a 52-53 week fiscal taxable year ending on the last Sunday of the year.

The Taxpayers have made the following representations in connection with the proposed Transaction:

(a) Controlled will not be indebted to Distributing after the Distribution of the Controlled Stock.

(b) The fair market value of the Controlled Stock and other consideration to be received by Shareholders C and H will be approximately equal to the fair market value of Distributing Stock surrendered by each of them in the exchange.

(c) 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 shareholder of the corporation.

(d) The 5 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.

(e) Except as provided later in this paragraph, following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior to consummation of the transaction. Distributing and Controlled will share the services of two employees: One employee will provide e-mail and computer network support and the other employee will provide POS (point-of-sale) System support. Each shared employee will be paid directly the fair market value of such services by each corporation. This arrangement will continue on a month-to-month basis until such time as Controlled acquires and implements its own system for providing these services. It is not

anticipated that this sharing period will extend beyond two years after the date of the Distribution.

(f) Distributing is an S corporation (within the meaning of section 1361(a)). Controlled will elect to be an S corporation pursuant to section 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 election of either the distributing or controlled corporation.

(g) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either the distributing or controlled corporation after the transaction, other than the issuance of stock to key employees and, possibly, the giving of gifts of non-voting stock by Shareholders to trusts for their respective children, pursuant to which no person or persons will acquire a fifty percent (50%) or greater interest in Distributing or Controlled during the four (4) year period beginning on the date that is two (2) years prior to the date of the Distribution.

(h) There is no plan or intention by either Distributing or Controlled, directly or through any 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.

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

(j) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under Section 357(d)) by Controlled plus any liabilities to which the transferred assets are subject.

(k) 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.

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

(m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution of the Controlled Stock.

(n) 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.

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

(p) The distribution of the stock of Controlled is carried out for the following corporate business purpose: To resolve a dispute among the Board of Directors and among the Shareholders of Distributing. The Distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.

(q) The distribution will not be a disqualified distribution within the meaning of section 355(d)(2) because, immediately after the distribution, no person (determined after applying section 355(d)(7)) will hold (directly or by attribution) disqualified stock constituting 50 percent or more of the total combined voting power of all classes of stock entitled to vote, or 50 percent or more of the total value of the shares of all classes of stock, of either Distributing or Controlled, that was acquired by purchase during the 5-year period ending on the date of the distribution.

(r) The distribution is not part of a plan or series of related transactions (within the meaning of section 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

Based solely on the information submitted and the representations as set forth above it is held as follows:

(1) The transfer by Distributing to Controlled of the assets and liabilities associated with the Acquired Stores, solely in exchange for all of the outstanding stock of Controlled, followed by the Distribution of the Controlled Stock by Distributing to Shareholders C and H in exchange for all of their Distributing Stock will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be a "party to a reorganization" within the meaning of § 368(b).

(2) Distributing will recognize no gain or loss upon the transfer of assets and liabilities to Controlled in exchange for Controlled Stock. Sections

361(a) and 357(a).

(3) Controlled will recognize no gain or loss on the receipt of assets and liabilities in exchange for the Controlled Stock. Section 1032(a).

(4) Controlled's basis in the assets received will be the same as the basis of such assets in the hands of Distributing immediately prior to the Transaction. Section 362(b).

(5) Controlled's holding period for the assets received from Distributing will include the period during which such assets were held by Distributing. Section 1223(2).

(6) Distributing will recognize no gain or loss upon the Distribution of all of its Controlled Stock in exchange for Distributing Stock held by Shareholders C and H. Section 361(c)(1).

(7) No gain or loss will be recognized to (and no amount will be included in the income of) Shareholders C and H upon the receipt of the Controlled Stock in exchange for all of their shares of Distributing Stock. Section 355(a)(1).

(8) The basis in the Controlled Stock held by each of Shareholders C and H after the Distribution will be the same as each of their basis in the Distributing Stock surrendered in exchange therefor. Section 358(a)(1).

(9) The holding period in the Controlled Stock received by each of Shareholders C and H will include the holding period of the Distributing Stock surrendered in exchange therefor, provided that the Distributing Stock is held as a capital assets by each of Shareholders C and H on the date of the exchange. Section 1223(1).

(10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) of the Income Tax Regulations.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the proposed transaction under any other provision of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction. Specifically, we express or imply no opinion concerning whether Distributing is a valid S corporation or whether Controlled is otherwise eligible to be an S corporation.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

This ruling is directed only to the taxpayer(s) requesting it. 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.

Sincerely yours,  
Steven J. Hankin  
Senior Technical Reviewer, Branch 6  
Associate Chief Counsel  
(Corporate)

cc: