

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:BR:06-PLR-155970-01
Date:
February 11, 2002

Legend

Distributing =

Controlled =

Business 1 =

Business 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

State A =

#a =

#b =

#c =

#d =

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#e =

#f =

#g =

#h =

#i =

#j =

#k =

#l =

#m =

#n =

#o =

#p =

#q =

#r =

#s =

#t =

#u =

#v =

#w =

#x =

#y =

#z =

#aa =

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#bb =

Person 1 =

Person 2 =

Person 3 =

Person 4 =

Person 5 =

Person 6 =

Person 7 =

Person 8 =

Person 9 =

Person 10 =

Person 11 =

Person 12 =

Person 13 =

Person 14 =

a =

b =

c =

d =

e =

f =

g =

h =

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n =

o =

Dear

This letter is in reply to your letters dated October 5, 2001, October 24, 2001, January 16, 2002 and February 1, 2002 requesting rulings as to the federal income tax consequences of a proposed transaction.

Distributing was formed on Date1, Distributing incorporated Controlled under the laws of State A. Distributing elected to be treated as an S Corporation effective as of Date 2. Distributing does not join in the filing of a consolidated federal income tax return.

On or about Date 3, Distributing incorporated Controlled under the laws of State A. Controlled will immediately elect to be treated as a qualified Subchapter S Subsidiary ("Qsub") of Distributing.

The authorized capital stock of Distributing consists of #a shares of voting common stock. Each share entitles the shareholder to one vote. There are no dividend or liquidation preferences. The percentage of voting common stock owned by each shareholder of Distributing prior to the distribution is as follows: Person 1 (#b), Person 2 (#c), Person 3 (#b), Person 4 (#d), Person 5 (#d), Person 6 (#d), Person 4, as custodian for Person 7 (#e), Person 4, as custodian for Person 8 (#f), Person 4, as custodian for Person 9 (#g), Person 5, as custodian for Person 10 (#f), Person 5, as custodian for Person 11 (#h), Person 12 (#d), Person 12, as custodian for Person 13 (#i), Person 12, as custodian for Person 14 (#g).

The authorized capital stock of Controlled will consist of #a shares of voting common stock. There will be no dividend or liquidation preferences. Distributing will own all of the #a shares of Controlled voting stock.

Since Date 1, Distributing has primarily been engaged in Business 1, including without limitation, a, b and c. Currently, Distributing owns #j separate a, b and c's.

Distributing has received gross rents in the amount of #k, #l, #m, #n, and #o, in Year 5, Year 4, Year 3, Year 2 and Year 1 respectively. Its total rental expenses for each of the last five years have been. #p in Year 5, #q in Year 4, #r in Year 3, #s in Year 2, and #t in Year 1.

Distributing is also engaged in the operation of Business 2. During Year 5, its gross sales were #u, but after all expenses were incurred its total income from operations amounted to #v. In Year 4, its gross sales were #w, but after expenses its total income from operations was only #x. It is anticipated that Business 2 will be closed in the near future, but it may in existence at the time of the split off. None of the

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assets of Business 2 will be distributed to Controlled or be a part of its operations following the split off. If Business 2 is in existence after the split off, its operations will remain unchanged.

The day to day management of n's currently owned by Distributing is performed exclusively by Person 12. Person 12's duties include d, e, f, and g. Any substantial decisions, however, such as h must be approved by Person 12's father, Person 1, who is the President of Distributing and one of three directors of Distributing. Person 12 is not an officer or a member of the board of directors of Distributing. Distributing currently has approximately #y employees who perform operational duties with respect to h including o.

Distributing has not issued any securities or bonds or any other outstanding interests other than two loans payable to Person 12 and Person 3, which as of Date 4, were in the amounts of #z and #aa, respectively. It is not anticipated that these loans will be satisfied prior to the time of the split off.

It is anticipated that prior to the split off, Distributing will obtain a loan of approximately #bb secured by one of the n's which will be transferred by Distributing to Controlled in the transaction. After the transaction, Controlled will assume this loan from Distributing. The net proceeds from the financing would be retained by Distributing for working capital and to pay off existing debt including the debt owed by Distributing to Person 12.

The transaction between Distributing and its shareholders will be as follows: Immediately after Distributing forms Controlled, Controlled will make an election to be treated as a QSub. Distributing will transfer eight pieces of n to Controlled. Distributing will remain maker and guarantor on loans with regard to three of these n's. Distributing will distribute all of the stock of Controlled to Person 12, Person 12, as custodian for Person 13, Person 12, as custodian for Person 14 solely in exchange for all their stock in Distributing (the "Distribution"). The Distribution will cause the termination of the QSub election of Controlled because Controlled will cease to be a 100% subsidiary of Distributing. As a result, under Treas. Reg. § 1.1361-5(b)(1)(i), Controlled will be treated as a new corporation acquiring all its assets (and assuming all of its liabilities) immediately before the Distribution from Distributing in exchange for stock of Controlled (the "Contribution").

Following the Contribution and Distribution, Person 12, Person 12, as custodian for Person 13, Person 12, as custodian for Person 14 will be the sole shareholders of Controlled and Person 1, Person 2, Person 3, Person 4, Person 5, Person 6, Person 4, as custodian for Person 7, Person 4, as custodian for Person 8, Person 4, as custodian for Person 9, Person 5, as custodian for Person 10, and Person 5, as custodian for Person 11 will be the shareholders of Distributing. Both Controlled and Distributing will then engage in Business 1 in substantially the same manner as Distributing has conducted such operations for the past five years.

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Notwithstanding any situation whereby Distributing might remain the maker or guarantor of loans made on n which will be contributed to Controlled, Controlled will be obligated to reimburse Distributing for such amounts.

After the split off, Controlled will be exclusively engaged in Business 1, including without limitation, a, b and c. Following the split off, Person 12 will be the exclusive manager of the day to day operations of Controlled. His duties will include d, e, f, and g. Person 12 will have the unrestricted ability to purchase or dispose of n. It is expected Controlled will employ a number of employees to perform administrative operational duties such as bookkeeping and accounting.

The business purpose for the distribution is that the separation of Business 1 will enhance the success of Business 1 by enabling Distributing and Controlled to resolve management, systemic, and other operational problems that have substantially deadlocked Distributing under the current business structure.

Distributing and Controlled submit that all of n, even those acquired within the past five years, are part of one integrated business and that the transfer of n to Controlled will constitute a vertical division of such single active business.

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

- (a) The indebtedness owed by the Controlled corporation to the Distributing corporation after the distribution of the Controlled corporation stock will not constitute stock or securities.
- (b) The fair market value of the Controlled corporation stock and other consideration to be received by each shareholder of the Distributing corporation will be approximately equal to the fair market value of the Distributing corporation stock.
- (c) 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.
- (d) 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.
- (e) Following the transaction, the Distributing and Controlled corporations 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 the consummation of the transaction.
- (f) The Distribution of stock of Controlled is carried out for the following

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corporate business purpose: to resolve between the shareholders of Distributing the management and operational differences that have inhibited the growth and prosperity of Distributing.

- (g) Distributing is currently an S corporation within the meaning of I.R.C. §1361(a). Controlled will elect to be an S corporation pursuant to I.R.C. § 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 Distributing or Controlled.
- (h) 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 Distributing or Controlled after the transaction.
- (i) 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).
- (j) There is no plan to either 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.
- (k) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (l) 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.
- (m) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of its transaction.
- (n) 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 corporation stock.
- (o) 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.
- (p) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

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- (q) 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.
- (r) 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 (d)(6)) ending on the distribution date.
- (s) 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 fifty percent or more of the total combined voting power of all classes of Distributing or Controlled common stock entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing or Controlled common stock.
- (t) The loans on n contributed by Distributing to Controlled are recourse liabilities. Controlled has agreed to and will satisfy such recourse liabilities, whether or not Distributing has been released of such recourse liabilities.

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

- (1) The Distribution will cause the termination of the QSub election of Controlled because Controlled will cease to be a wholly owned subsidiary of Distributing. As a result, Controlled will be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the Distribution from Distributing in exchange for stock of Controlled (the 'Contribution'). Section 1.1361-5(b)(1)(i).
- (2) The Contribution, followed by the distribution of Controlled stock by Distributing to certain Distributing shareholders will constitute a reorganization under section 368(a)(1)(D). Distributing and Controlled each will be a 'party to a reorganization' under section 368(b).
- (3) No gain or loss will be recognized by Distributing on the Contribution. Section

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361(a).

- (4) No gain or loss will be recognized by Controlled on the Contribution. Section 1032(a).
- (5) The basis of each asset deemed received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing. Section 362(b).
- (6) The holding period of each asset deemed received by Controlled will include the holding period of that asset in the hands of Distributing. Section 1223(2).
- (7) No gain or loss will be recognized by Distributing on the distribution of the stock of Controlled to the shareholders of Distributing. Section 361(c).
- (8) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the shareholders of Distributing on their receipt of Controlled stock in the Distribution. Section 355(a)(1).
- (9) The basis of the Controlled stock in the hands of Distributing's shareholders who exchange all of their Distributing stock for shares of Controlled common stock will be the same as the basis in the Distributing stock surrendered in exchange therefor. Section 358(a)(1).
- (10) The holding period of the Controlled stock received by the Transferors will include the holding period of the Distributing stock on which the distribution is made, provided the stock is held as a capital asset on the date of the distribution. Section 1223(1).
- (11) Earnings and profits will be allocated between Distributing and Controlled in accordance with sections 312(h) and Treas. Reg. § 1.312-10(a).

No opinion is expressed about the tax treatment of the proposed transaction under other provisions 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 that are not directly covered by the above rulings.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter should be attached to the federal income tax return of the taxpayer involved for the taxable year in which the transaction covered by this ruling letter is consummated.

The rulings contained in this letter are predicated upon the 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 material submitted in support of the request for a ruling. Verification of the factual information, representations, and other data may be required as part of the audit

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process.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to your authorized representative.

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

cc: