

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:

CC:CORP:B05 – PLR-124741-03

Date:

August 14, 2003

In re:

LEGEND

Controlled =

Distributing =

PP 1 =

PP 2 =

PP 3 =

PP 4 =

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PP 5 =

PP 6 =

PP 7 =

PP 8 =

PP 9 =

PP 10 =

PP 11 =

PP 12 =

PP 13 =

PP 14 =

PP 15 =

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PP 16 =

PP 17 =

PP 18 =

PP 19 =

PP 20 =

PP 21 =

PP 22 =

PP 23 =

PP 24 =

PP 25 =

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PP 26 =

PP 27 =

PP 28 =

Corp A =

Shareholder A =

Shareholder B =

Shareholder C =

State X =

State X Bank =

Business A =

Business B =

Dear

This letter responds to your April 7, 2003, request for rulings on certain federal income tax consequences of a proposed transaction. The facts submitted for consideration are substantially as set forth below.

Distributing is a State X corporation which is engaged through related State X partnerships in Business A and Business B. Distributing has outstanding a single class of voting common stock, fifty percent of which is held by each of Shareholder A and Shareholder B.

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The partnerships engaged in Business A are as follows:

<u>Partnership</u>	<u>Partnership Interest Held by Distributing (or by a related partnership)</u>
PP 1	90.00 percent
PP 2	90.00 percent
PP 3	13.25 percent
PP 4	92.50 percent
PP 5	83.30 percent
PP 6	83.50 percent
PP 7	2.00 percent
	(20.41 percent held by PP 3)
PP 8	10.00 percent
	(50 percent held by PP 1)
PP 9	0.00 percent
	(49.33 percent held by PP 1)

Corp A, a State X corporation, which is wholly-owned by Shareholder C, holds partnership interests in PP 1, PP 2, and PP 3 of 10 percent, 10 percent, and 13.25 percent, respectively. The remaining interests in the Business A partnerships are held by employees of PP 3 (73.5 percent in PP 3) and others.

Business B is conducted through 64 general partnerships. Distributing has been the principal or sole general partner in, and the sole manager of, 19 of the partnerships, for the last five years, as follows:

<u>Partnership</u>	<u>Partnership Interest Held by Distributing</u>
PP 10	78.125 percent
PP 11	75 percent
PP 12	53.333 percent
PP 13	66.667 percent
PP 14	66.667 percent
PP 15	50 percent
PP 16	60 percent
PP 17	43.33 percent
PP 18	60 percent
PP 19	50 percent
PP 20	27.6 percent
PP 21	43.5 percent
PP 22	43.3603 percent

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PP 23	45.18 percent
PP 24	61 percent
PP 25	80 percent
PP 26	36.667 percent
PP 27	43.74 percent
PP 28	12.075 percent

Financial information has been submitted which indicates that each of Business A (including each of PP 1, PP 2, PP 4, and PP 5) and Business B (including each of PP 10 through 27) has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

It is represented that Distributing, as a general partner with a majority in interest in PP 1, PP 2, PP 4, and PP 5 performs active and substantial management functions for each of these partnerships, including the decision-making regarding significant business decisions of the partnerships and regular participation in the overall supervision, direction, and control of the employees of the partnership in operating the partnership's business.

None of the partnerships in Business B has any employees. Distributing's employees manage and operate Business B. It is represented that Distributing, as a general partner in PP 10 through 27 performs active and substantial management functions for each of these partnerships, including the decision-making regarding significant business decisions of the partnerships and regular participation in the overall supervision, direction, and control of the employees of the partnership in operating the partnership's business.

Over the years Distributing has expanded its Business A through the opening of new business locations. Frequently, Distributing has utilized debt financing for much of the necessary capital. In addition, it is deemed desirable that Business A self-insure a portion of its workers' compensation exposure. State X Bank, a historical lender to Distributing, has informed Distributing that a consolidation of Business A in a corporation separate from Business B as set forth in the proposed transaction would enable the bank to lend money to it on significantly better nonfinancial terms.

Distributing needs to raise a substantial amount of capital during the first year following the distribution for the above reasons. The funds raised in the borrowing will be used, under all circumstances, in pursuing expansion efforts and/or in establishing a workers' compensation plan. At least one substantial borrowing will be completed within one year of the distribution. The borrowed funds will be used shortly thereafter.

Accordingly, the following steps are proposed:

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- (i) Distributing will organize Controlled, a State X corporation, and will transfer all of the assets associated with Business A to Controlled in exchange for Controlled voting common stock. Included in the transfer will be Distributing's partnership interests in PP 1, PP 2, PP 3, PP 4, PP 5, PP 6, PP 7, and PP 8. The remaining unincorporated persons who own interests in the partnerships that engage in Business A, will simultaneously contribute their partnership interests to Controlled in exchange for Controlled voting common stock. After the contributions, Distributing will own in excess of 80 percent of the outstanding Controlled stock.
- (ii) Distributing will distribute all of its Controlled stock to Shareholder A and Shareholder B on a pro rata basis.
- (iii) Corp A and any other incorporated persons who own interests in the partnerships engaged in Business A will merge with and into Controlled pursuant to the laws of State X. Pursuant to the merger, Shareholder C and the other shareholders will receive solely voting common stock of Controlled, having a fair market value approximately equal to the fair market value of the stock of the respective merged entity. After the mergers, Shareholder A and Shareholder B will continue to own, in the aggregate, more than 50 percent of the stock of Controlled.

Subsequent to the transaction it is intended that Controlled will rent one of its Business A premises from one of the Business B partnerships on arm's length terms at an arm's length rent.

In connection with the proposed transaction, it has been represented that:

- (a) No part of the consideration to be distributed by Distributing will be received by a shareholder of Distributing as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (b) The 5 years of financial information submitted on behalf of each of Business A and Business B is representative of the present operations, and with regard to each business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the transactions, each of Distributing and Controlled will continue the active conduct of its business, independently and with its own employees.

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(d) The distribution is being undertaken for the corporate business purpose of facilitating borrowing by Business A on significantly better nonfinancial terms than are otherwise available. The distribution is motivated, in whole or substantial part, by this corporate business purpose.

(e) Distributing is an S corporation (within the meaning of § 1361(a)). Controlled will elect to be an S corporation pursuant to § 1362(a) on the first available date after the distribution and there is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

(f) Neither Shareholder A nor Shareholder B has any plan or intention to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the distribution.

(g) 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 Distribution.

(h) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, other than as described in step (iii) of the transaction, or to sell or otherwise dispose of the assets of either corporation after the distribution, except in the ordinary course of business.

(i) The distribution is not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50 percent or greater interest (as defined in § 355(d)(4)) in Distributing or Controlled.

(j) Immediately after the distribution, no person will hold, directly or indirectly, disqualified stock (within the meaning of § 355(d)(3)) in Distributing or Controlled that constitutes a 50 percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled.

(k) The total adjusted bases and the fair market values of the assets to be transferred to Controlled by Distributing in the transaction will, in each instance, equal or exceed the sum of the liabilities assumed (as determined under § 357(d)) by Controlled.

(l) The liabilities to be assumed (as determined under § 357(d)) by Controlled in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

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(m) None of the transferred assets includes property that will be subject to investment tax credit recapture.

(n) Except for indebtedness that arises in connection with the rental of Business A premises, as described above, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution. Any such debt will constitute debt not amounting to a security.

(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 transactions are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

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

- (1) The transfer by Distributing and Controlled of the assets associated with Business A in exchange for in excess of 80 percent of the outstanding stock in Controlled, followed by the distribution of such Controlled stock to Shareholder A and Shareholder B will be a reorganization within the meaning of § 368(a)(1)(D) of the Internal Revenue Code. Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing on its contribution of the assets associated with Business A to Controlled in exchange for Controlled stock (§§ 361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled on the receipt of the assets associated with Business A in exchange for Controlled stock (§ 1032(a)).
- (4) The basis of the assets associated with Business A that Controlled receives will be the same as the basis of those assets in the hands of Distributing immediately prior to transfer (§ 362(b)).
- (5) The holding period of the assets associated with Business A that Controlled receives will include the respective periods during which such assets were held by Distributing (§ 1223(2)).

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- (6) No gain or loss will be recognized by (and no amount will be included in the income of) the stockholders of Distributing on the receipt of the Controlled stock (§ 355(a)).
- (7) The basis of the stock of Distributing and Controlled in the hands of Shareholder A and Shareholder B immediately after the distribution of Controlled stock will be the same as the aggregate basis of the Distributing stock in the hands of Shareholder A and Shareholder B immediately before the distribution allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) of the Income Tax Regulations (§§ 358(b)).
- (8) The holding period of the Controlled stock received by Stockholder A and Shareholder B will include the holding period of the Distributing stock with respect to which it was distributed , provided that such stockholder held the Distributing stock as a capital asset on the date of the distribution (§ 1223(1)).
- (9) No gain or loss will be recognized by Distributing on the distribution to its stockholders of all of its Controlled stock (§ 361(c)).
- (10) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Controlled and Distributing will be made under § 1.312-10(a).

No opinion is expressed about the tax consequences of the 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 transaction that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested 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 returns of the taxpayers involved for the taxable year in which transaction covered by this ruling letter in consummated.

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

Sincerely,

Debra Carlisle
Chief, Branch 5
Office of Associate Chief Counsel
(Corporate)

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cc: