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LEGEND

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

Acquiring =

Shareholder A =

Shareholder B =

Shareholder C =

Date D =

Date E =

Business X =

Business Y =

a =

b =

Dear :

This letter responds to your September 12, 2011 request for rulings under sections 355, 368 and related provisions with respect to the Proposed Transaction (defined below). The information submitted in that request and in subsequent correspondence 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 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 50-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 subchapter S corporation that is engaged through wholly owned qualified subchapter S subsidiaries (each, a “QSub”) and wholly owned limited liability companies in Business X and Business Y. Distributing has one class of common stock outstanding, which is owned a percent by Shareholder A, a percent by Shareholder B, and b percent by Shareholder C.

Distributing wholly owns, among other entities, Sub 1, Sub 2, and Sub 3. Sub 1 is a QSub that directly conducts Business X and Business Y. Sub 2 is a QSub that directly conducts Business Y. Sub 3 is a QSub that was formed on Date D for purposes of the Proposed Transaction. Financial information submitted by Distributing indicates that Business X and Business Y each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

On Date E, the shareholders of Distributing formed Acquiring, and Acquiring made an election under § 1362 to be taxed as a subchapter S corporation. Acquiring has one class of common stock outstanding, which is owned a percent by Shareholder A, a percent by Shareholder B, and b percent by Shareholder C.

Proposed Transaction

For what are represented to be valid business reasons, Distributing has proposed the following transaction to separate Business Y from Business X (the “Proposed Transaction”):

- (i) Distributing will form Controlled and elect to treat Controlled as a QSub pursuant to § 1361(b)(3)(B).
- (ii) Sub 1 will transfer all of its assets and operations related to Business Y to Distributing, and Distributing will contribute such assets to Sub 3.
- (iii) Distributing will then transfer all of the stock of Sub 2 and Sub 3 to Controlled and distribute pro rata all the Controlled stock to the shareholders of Distributing (the “Distribution”). Pursuant to § 1.1361-5(b)(1)(i), the Distribution will cause a termination of Controlled’s QSub election with Controlled being treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) from Distributing immediately before the Distribution in exchange for the stock of Controlled (the “Contribution”).

- (iv) Immediately after the Distribution, the shareholders of Distributing will contribute all of their Controlled stock to Acquiring (the "Acquisition").
- (v) Immediately after the Acquisition, Acquiring will liquidate Controlled under applicable state law (the "Liquidation") and will elect to treat both Sub 2 and Sub 3 as subchapter S subsidiaries pursuant to § 1361(b)(3)(B).

Representations

Contribution and Distribution

The taxpayer makes the following representations regarding the Contribution and the Distribution:

- (a) The indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Distributing in the Distribution 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 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) Neither Business X nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized under proposed § 1.355-3) in whole or in part. Throughout the five-year period ending on the date of the Distribution, Distributing has been the principal owner of the goodwill and significant assets of Business X and will continue to be the principal owner following the Distribution.
- (e) Following the transaction, Distributing will continue the active conduct of its business, independently and with its separate employees.
- (f) The five years of financial information submitted on behalf of Controlled is representative of its present operations, and with regard to such operations, there have been no substantial operational changes since the date of the last financial statements submitted.

(g) Neither Business Y nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized under proposed § 1.355-3) in whole or in part. Throughout the five-year period ending on the date of the Distribution, Distributing will have been the principal owner of the goodwill and significant assets of Business Y, and Controlled (or its successor) will be the principal owner following the Distribution.

(h) Following the transaction, Controlled (or its successor) will continue the active conduct of its business, independently and with its separate employees.

(i) The Distribution is being carried out for the following corporate business purposes: (i) to allow Business Y to separately borrow from third party lenders and independently market its business and (ii) to market its business to customers of Business X. The Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.

(j) The transaction is not being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both. See § 355(a)(1)(B).

(k) 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.

(l) 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.

(m) 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).

- (n) Immediately after the transaction (taking into account § 355(g)(4)), either (i) no person will hold a 50-percent or greater interest (within the meaning of § 355(g)(3)) in the stock of Distributing or Controlled who did not hold such an interest immediately before the transaction or (ii) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).
- (o) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing will 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.
- (p) The liabilities assumed, if any, (as determined under § 357(d)) by Controlled were incurred in the ordinary course of business and are associated with the assets being transferred.
- (q) The total fair market value of the assets transferred by Distributing 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 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. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
- (r) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, other than intercompany loans or obligations that have arisen, or will arise, between the parties in the ordinary course of business.
- (s) 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.
- (t) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (u) Distributing and Controlled each will pay its own expenses, if any, incurred in connection with the Distribution.
- (v) Distributing is a subchapter S corporation (within the meaning of § 1361(a)). There is no plan or intention to revoke or otherwise terminate the S corporation election of Distributing.

(w) No property deemed transferred between Distributing and Controlled has, or will, claim investment credit under § 46.

Acquisition and Liquidation

The taxpayer makes the following representations regarding the Acquisition and the Liquidation:

(x) The fair market value of the Acquiring stock and other consideration received by each shareholder of Controlled will be approximately equal to the fair market value of the Controlled stock surrendered in the exchange.

(y) At least 40 percent of the proprietary interest in Controlled will be exchanged for stock of Acquiring and will be preserved (within the meaning of § 1.368-1(e)).

(z) Acquiring will acquire at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Controlled immediately prior to the Proposed Transaction. For purposes of this representation, amounts paid by Controlled to dissenters, amounts paid by Controlled to shareholders who receive cash or other property, amounts used by Controlled to pay its reorganization expenses, and all redemptions and distributions (except for regular, normal dividends) made by Controlled immediately preceding the transfer will be included as assets of Controlled immediately prior to the Proposed Transaction.

(aa) After the Proposed Transaction, the shareholders of Controlled will be in control of Acquiring within the meaning of § 368(a)(2)(H).

(bb) Neither Acquiring nor any person related to Acquiring (within the meaning of § 1.368-1(e)(3)) has any plan or intention to reacquire any stock of Acquiring issued in the Proposed Transaction.

(cc) Acquiring has no plan or intention to sell or otherwise dispose of any of the assets of Controlled acquired in the Proposed Transaction, except for dispositions made in the ordinary course of business.

(dd) The liabilities of Controlled assumed (as determined under § 357(d)) by Acquiring and the liabilities, if any, to which the transferred assets are subject were incurred by Controlled in the ordinary course of its business and are associated with the assets transferred.

(ee) Following the Proposed Transaction, Acquiring will continue the historic business of Controlled or use a significant portion of Controlled's historic business assets in a business.

(ff) At the time of the Proposed Transaction, Acquiring will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Acquiring that, if exercised or converted, would affect the acquisition or retention of control (as defined in § 368(a)(2)(H)).

(gg) Acquiring, Controlled, and the shareholders of Controlled will each pay their respective expenses, if any, incurred in connection with the Proposed Transaction.

(hh) There is no intercorporate indebtedness existing between Acquiring and Controlled that was issued, acquired, or will be settled at a discount.

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

(jj) The fair market value of the assets of Controlled transferred to Acquiring will equal or exceed the sum of the liabilities of Controlled assumed (as determined under § 357(d)) by Acquiring, plus the amount of liabilities, if any, to which the transferred assets are subject.

(kk) Controlled is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

(ll) Acquiring is a subchapter S corporation (within the meaning of § 1361(a)). There is no plan or intention to revoke or otherwise terminate the S corporation election of Acquiring.

Rulings

Contribution and Distribution

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

(1) The Contribution followed by the Distribution will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be “a party to a reorganization” within the meaning of § 368(b).

(2) Distributing will recognize no gain or loss on the Contribution (§§ 357(a) and 361(a)).

(3) Controlled will recognize no gain or loss on the Contribution (§ 1032(a)).

- (4) Controlled's basis in each of the assets received in the Contribution will be the same as the basis of the asset in the hands of Distributing immediately before the Contribution (§ 362(b)).
- (5) Controlled's holding period in each of the assets received in the Contribution will include the period during which Distributing held such asset (§ 1223(2)).
- (6) Distributing will recognize no gain or loss on the Distribution (§ 361(c)).
- (7) Distributing's shareholders will recognize no gain or loss (and no amount will be includible in their income) on the receipt of Controlled stock in the Distribution (§ 355(a)(1)).
- (8) The aggregate basis of the Controlled stock and the Distributing stock in the hands of Distributing's shareholders immediately after the Distribution will be the same as the aggregate basis of the Distributing stock held by the Distributing shareholders immediately before the Distribution, allocated between the stock of Distributing and Controlled in proportion to the fair market value of each in accordance with § 1.358-2(a) (§ 358(a), (b), and (c)).
- (9) The holding period of the Controlled stock received by each Distributing shareholder will include the holding period of the Distributing stock held by each shareholder, provided the Distributing stock was held as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) As provided in § 312(h), earnings and profits will be allocated between Distributing and Controlled in accordance with § 1.312-10(a).
- (11) The accumulated adjustments account of Distributing will be allocated between Distributing and Controlled in a manner that is similar to the manner in which earnings and profits of Distributing will be allocated under § 312(h) in accordance with § 1.1368-2(d)(3).
- (12) Controlled's momentary ownership of the stock of Sub 2 and Sub 3 as part of the reorganization under § 368(a)(1)(D) will not prevent Acquiring from electing to treat Sub 2 and Sub 3 as QSubs of Acquiring before the expiration of the five year period described in § 1361(b)(3)(D) and § 1.1361-5(c)(1) provided that:
 - a. Immediately following the termination of their status as QSubs, Sub 2 and Sub 3 are each otherwise eligible to have a QSub election made for it; and
 - b. The elections are made effective immediately following the termination of Controlled's QSub election.

Acquisition and Liquidation

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

(13) The Acquisition and Liquidation will be treated for federal income tax purposes as the transfer by Controlled of substantially all of its assets to Acquiring solely in exchange for Acquiring stock and the assumption by Acquiring of Controlled's liabilities. (Rev. Rul. 67-274, 1967-2 C.B. 141).

(14) The transfer by Controlled of substantially all of its assets to Acquiring solely in exchange for Acquiring stock and the assumption by Acquiring of the liabilities of Controlled will constitute a reorganization within the meaning § 368(a)(1)(D). For purposes of this ruling, "substantially all" means at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets of Controlled. Acquiring and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).

(15) No gain or loss will be recognized by Controlled on the transfer of all of its assets to Acquiring in exchange for Acquiring stock and the assumption by Acquiring of Controlled's liabilities, as described above (§ 361(a) and § 357(a)).

(16) No gain or loss will be recognized by Controlled on the distribution of the Acquiring stock to its shareholders (§ 361(c)(1)).

(17) No gain or loss will be recognized by Acquiring on its receipt of the assets of Controlled in exchange for Acquiring stock (§ 1032(a)).

(18) The basis of Controlled's assets in the hands of Acquiring will be the same as the basis of such assets in the hands of Controlled immediately before their transfer (§ 362(b)).

(19) The holding period of Controlled's assets in the hands of Acquiring will include the period during which such assets were held by Controlled (§ 1223(2)).

(20) No gain or loss will be recognized by Shareholder A, Shareholder B, and Shareholder C on their receipt of the Acquiring stock in exchange for their Controlled stock, as described above (§ 354(a)(1)).

(21) The basis of the shares of the Acquiring stock received by Shareholder A, Shareholder B, and Shareholder C will be the same as their bases in the Controlled stock surrendered in exchange therefor (§ 358(a)(1)).

(22) The holding period of the Acquiring stock received by Shareholder A, Shareholder B, and Shareholder C will include the holding period of the Controlled stock surrendered in exchange therefor, provided that the Controlled stock is held as a capital asset on the date of the exchange (§ 1223(1)).

Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations or on the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, this office has not reviewed any information pertaining to and has made no determination regarding:

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

(ii) Whether the Distribution 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));

(iii) Whether the Distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii);

(iv) Whether Distributing or Acquiring otherwise meets the requirements of a subchapter S corporation under § 1361; and

(v) Whether Controlled, Sub 1, Sub 2, or Sub 3 otherwise meets the requirements of a QSub under § 1361.

Procedural Statements

This ruling is directed only to the taxpayer requesting 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,

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel (Corporate)