

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:
June 29, 2012

Legend

Distributing =

Controlled 1 =

Controlled 2 =

Business A =

Business B =

Business C =

Business D =

Land =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

State X =

Date 1 =

Date 2 =

a =

b =

c =

d =

Dear :

This letter responds to your March 26, 2012, request for rulings on certain federal income tax consequences of the Proposed Transaction (defined below). The information provided in that request and in later 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 material 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 Distributions (defined below): (i) satisfy the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) are being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1, or Controlled 2, or any combination thereof (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)); or (iii) are 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, Controlled 1, or Controlled 2 (see § 355(e) and § 1.355-7).

Summary of Facts

Distributing is a closely held State X corporation that was incorporated on Date 1. Since Date 2, Distributing has been treated as a subchapter S corporation. Distributing has

one class of stock outstanding, voting common stock. Distributing's stock is owned equally by Shareholder 1, Shareholder 2, and Shareholder 3 (the "Shareholders").

Distributing is engaged in Business A, Business B, Business C, and Business D. Distributing also owns the Land. The financial information submitted by Distributing indicates that Business A, Business B, and Business D has each had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Disagreements have developed among the Shareholders concerning the operation and management of Business B, Business C, and Business D. Shareholder 1 is interested in Business B and Business C. Shareholder 2 is interested in Business D. Shareholder 3 is not interested in any of these businesses. Accordingly, Distributing has structured the Proposed Transaction, described below.

Proposed Transaction

For what is represented to be a valid business purpose, Distributing has proposed the following transaction (the "Proposed Transaction"):

- (i) Distributing will form Controlled 1 and Controlled 2 as State X corporations. Each Controlled will make an election under § 1362(a) to be treated as a subchapter S corporation and will have one class of stock outstanding, voting common stock.
- (ii) Distributing will transfer the assets of Business B and Business C to Controlled 1 in exchange for all of the stock of Controlled 1 and the assumption by Controlled 1 of the liabilities associated with those assets and of the Loan Obligation (described below). Distributing will transfer the assets of Business D and \$a to Controlled 2 in exchange for all of the stock of Controlled 2 and the assumption by Controlled 2 of the liabilities associated with those assets (the "Contributions").
- (iii) Distributing will distribute all of the Controlled 1 stock to Shareholder 1, and all of the Controlled 2 stock to Shareholder 2 (the "Distributions").
- (iv) Distributing will distribute \$b to Shareholder 3 (the "Cash Distribution").

Prior to the Proposed Transaction, Shareholder 1 will loan \$c to Distributing in exchange for a promissory note with a rate of interest equal to the Applicable Federal Rate (the "Loan Obligation"). Also prior to the Proposed Transaction, Distributing will sell the Land for cash (the "Sale"). In the Contributions, to equalize the value of Controlled 1 with the value of Controlled 2, Distributing will transfer the \$c received from Shareholder 1 and an additional \$d received in the Sale to Controlled 2, and Controlled 1 will assume the Loan Obligation. The remainder of the proceeds received in the Sale will be used, as necessary, to fund the Cash Distribution.

After the Proposed Transaction, the Shareholders will continue to own equally all of the stock of Distributing and Distributing will be engaged in Business A. Shareholder 1 will own all of the stock of Controlled 1, which will be engaged in Business B and Business C and Shareholder 2 will own all of the stock of Controlled 2, which will be engaged in Business D.

Representations

The following representations are made with regard to the Proposed Transaction:

- (a) The indebtedness, if any, owed by Controlled 1 or Controlled 2 to Distributing after the Distributions will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Distributing in the Distributions will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted for Business A conducted by Distributing is representative of the business's present operation, and with regard to this business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) The five years of financial information submitted for Business B to be transferred to Controlled 1 is representative of the business's present operation, and with regard to this business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) The five years of financial information submitted for Business D to be transferred to Controlled 2 is representative of the business's present operation, and with regard to this business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) Neither Business A nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distributions in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the Distributions, Distributing will have been the principal owner of the goodwill and significant assets of Business A and will continue to be the principal owner following the Distributions.
- (g) Neither Business B nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distributions in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the Distributions,

Distributing will have been the principal owner of the goodwill and significant assets of Business B. Following the Distributions, Controlled 1 will be the principal owner of the goodwill and significant assets of Business B.

- (h) Neither Business D nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distributions in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the Distributions, Distributing will have been the principal owner of the goodwill and significant assets of Business D. Following the Distributions, Controlled 2 will be the principal owner of the goodwill and significant assets of Business D.
- (i) Following the Distributions, Distributing, Controlled 1, and Controlled 2 will each continue the active conduct of its business, independently and with its separate employees.
- (j) The Distributions are being carried out for the following corporate business purposes: (i) fit and focus; (ii) efficiency of management; and (iii) reduction of costs. The Distributions are motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (k) The Distributions are not being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1, or Controlled 2, or any combination thereof.
- (l) For purposes of § 355(d), immediately after the Distributions, no person (determined after applying the aggregation rules of § 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 Distributions.
- (m) For purposes of § 355(d), immediately after the Distributions, no person (determined after applying the aggregation rules of § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled 1 or Controlled 2 stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled 1 or Controlled 2 stock that either: (i) 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 Distributions; or (ii) is received in the Distributions to the extent 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 Distributions.

- (n) The total adjusted basis of the assets Distributing will transfer to each Controlled in the Contributions will equal or exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by the respective Controlled in the Contributions; and (ii) the sum of any money and the fair market value of any other property (within the meaning of § 361(b)) received by Distributing from the respective Controlled in the Contributions and transferred by Distributing to its creditors in connection with the reorganization.
- (o) Other than the Loan Obligation, the liabilities assumed (within the meaning of § 357(d)) by each Controlled in the Contributions and the liabilities to which the transferred assets are subject will have been incurred in the ordinary course of business and will be associated with the assets being transferred.
- (p) The total fair market value of the assets Distributing will transfer to each Controlled in the Contributions will exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by the respective Controlled in the Contributions; (ii) the amount of any liabilities owed to the respective Controlled by Distributing that are discharged or extinguished in connection with the Contributions; 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 from the respective Controlled in the Contributions. The fair market value of the assets of each Controlled will exceed the amount of its liabilities immediately after the Contributions.
- (q) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.
- (r) No intercorporate debt will exist among Distributing, Controlled 1, and Controlled 2 at the time of, or subsequent to, the Distributions.
- (s) Payments made in connection with all continuing transactions, if any, among Distributing, Controlled 1, and Controlled 2, 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) The Distributions are 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, Controlled 1, or Controlled 2 (including any predecessor or successor of any such corporation).

- (v) Immediately after the transaction (as defined in § 355(g)(4)), either: (i) neither Distributing, Controlled 1, nor Controlled 2 will be a disqualified investment corporation (within the meaning of § 355(g)(2)); or (2) no person will hold a 50-percent or greater interest (within the meaning of § 355(g)(3)) in any disqualified investment corporation (within the meaning of § 355(g)(2)), who did not hold such an interest in such corporation immediately before the transaction (as defined in § 355(g)(4)).
- (w) Distributing, Controlled 1, Controlled 2, and the Shareholders, will each pay their own expenses, if any, incurred in connection with the Proposed Transaction.
- (x) The \$c loaned by Shareholder 1 in exchange for the Loan Obligation will come solely from Shareholder 1 and the Loan Obligation is a bona fide debt, incurred at arms-length, reflected by a written promissory note with a rate of interest equal to the Applicable Federal Rate.

Rulings

Based solely on the information submitted and representations made, we rule as follows with regard to the Proposed Transaction:

- (1) Each of the contributions, followed by its respective distribution, will qualify as a reorganization within the meaning of § 368(a)(1)(D). With respect to each reorganization, Distributing and the respective Controlled will be “a party to a reorganization” under § 368(b).
- (2) No gain or loss will be recognized to Distributing on the Contributions (§§ 361(a), 357(a)).
- (3) No gain or loss will be recognized to Controlled 1 or Controlled 2 on the Contributions (§ 1032(a)).
- (4) The basis of each asset acquired by Controlled 1 or Controlled 2 in the Contributions will equal the basis of that asset in Distributing’s hands immediately before the Contributions (§ 362(b)).
- (5) Controlled 1 and Controlled 2’s holding period for each asset acquired in the Contributions will include the period Distributing held that asset (§ 1223(2)).
- (6) No gain or loss will be recognized to Distributing on the Distributions (§ 361(c)(1)).
- (7) No gain or loss will be recognized to (and no amount will be includible in the income of) Shareholder 1 or Shareholder 2 on the receipt of Controlled 1 or Controlled 2 stock in the Distributions (§ 355(a)(1)).

- (8) The basis of the Distributing and Controlled 1 or Controlled 2 stock in the hands of Shareholder 1 and Shareholder 2 immediately after the Distributions will equal the basis of the Distributing stock held by the shareholder immediately before the Distributions, allocated between the stock of Distributing and Controlled 1 or Controlled 2 in proportion to the fair market value of each immediately following the Distributions in accordance with § 1.358-2(a)(2) (§ 358(b)(2), 358(c)).
- (9) Shareholder 1 and Shareholder 2's holding period for the Controlled 1 or Controlled 2 stock received in the Distributions will include the period the shareholder held the Distributing stock with respect to which the Distributions are made, provided the shareholder held that stock as a capital asset on the date of the Distributions (§ 1223(1)).
- (10) Earnings and profits will be allocated between Distributing, Controlled 1, and Controlled 2 in accordance with § 312(h) and § 1.312-10(a).
- (11) Distributing's accumulated adjustments account immediately before the Contributions and Distributions will be allocated among Distributing, Controlled 1 and Controlled 2 in a manner similar to the manner in which the earnings and profits of Distributing will be allocated under § 312(h) in accordance with § 1.1368-2(d)(3).
- (12) Controlled 1 and Controlled 2 will be subject to § 1374 with respect to all assets they acquire in the Contributions to the same extent Distributing is subject to § 1374 with respect to those assets. For purposes of § 1374, Controlled 1 and Controlled 2's recognition period will be reduced by the portion of Distributing's recognition period that expires prior to the Contributions (§ 1374(d)(8)).
- (13) Distributing's momentary ownership of the stock of Controlled 1 and Controlled 2, as part of the Contributions and Distributions, will not cause Controlled 1 or Controlled 2 to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If each of Controlled 1 and Controlled 2 otherwise meets the requirements of a small business corporation under § 1361, it will be eligible to elect to be a subchapter S corporation under § 1362(a) for its first taxable year.
- (14) Section 1368, and not section 356, will apply to the Cash Distribution.

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 conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, we express no opinion regarding: (i) whether the Distributions satisfy the business purpose requirement of § 1.355-2(b); (ii)

whether the Distributions are being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1, or Controlled 2, or any combination thereof (see § 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Distributions are 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, Controlled 1, or Controlled 2 (see § 355(e) and § 1.355-7).

Procedural Statements

This ruling letter is directed only to the taxpayer who requested 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 this ruling letter.

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

Sincerely,

Mark J. Weiss
Mark J. Weiss
Reviewing Attorney, Branch 6
Office of Associate Chief Counsel (Corporate)

cc: