

Internal Revenue Service

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Third Party Communication: None
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Person To Contact: , ID No.

Telephone Number:

Refer Reply To:
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Date:
November 26, 2012

Legend

Distributing =

Controlled =

Operating =

Predecessor =

Shareholder A =

Shareholder B =

Trust A =

Trust B =

Business A =

aa% =

bb% =

cc% =

dd% =

State A =

Date 1 =

Date 2 =

Dear :

This letter responds to a letter dated July 6, 2012 requesting rulings as to certain federal income tax consequences to the proposed transaction described below (the "Proposed Transaction"). 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.

Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the Distribution (defined in Step (iii) below): (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled, or both (see section 355(a)(1)(B) and Treas. Reg. § 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 section 355(e)(2)(A)(ii) and Treas. Reg. § 1.355-7).

SUMMARY OF FACTS

Distributing is a State A entity that was formed on Date 2 as a successor entity to Predecessor and has elected to be treated as a Subchapter S corporation for federal income tax purposes since its formation. Distributing is closely held and owned by Shareholder A, an individual, Trust A, a grantor trust with Shareholder A as its grantor, Shareholder B, an individual, and Trust B, a grantor trust with Shareholder B as its grantor. Together, Shareholder A and Trust A own aa% of the stock of Distributing. Together, Shareholder B and Trust B own bb% of the stock of Distributing. Operating is a State A limited liability company that was formed on Date 1, and is treated as a

partnership for federal income tax purposes. Distributing owns cc% of the membership interests in Operating. Other investors, unrelated to Distributing's shareholders, own the remaining membership interests in Operating.

The taxpayer has submitted financial information indicating that Business A as conducted by Distributing through Operating has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the five years preceding the Proposed Transaction.

PROPOSED TRANSACTION

For what are represented to be valid business reasons, the taxpayer proposes to undertake the following Proposed Transaction:

- (i) Distributing will form Controlled as a State A corporation that will elect to be treated as a Subchapter S corporation for federal income tax purposes. Distributing will own all of the stock of Controlled.
- (ii) Distributing will contribute dd% of the membership interests in Operating to Controlled (the "Contribution").
- (iii) Distributing will distribute all of the stock of Controlled to Individual B and Trust B in complete redemption of their interests in Distributing (the "Distribution").

REPRESENTATIONS

The following representations have been made with respect to the Proposed Transaction:

- (a) No part of the consideration to be distributed by Distributing in the Distribution will be received by Individual B or Trust B as a creditor, employee, or in any capacity other than a shareholder of Distributing.
- (b) No part of the consideration to be distributed by Distributing in the Distribution will be received by a security holder as an employee or in any capacity other than that of a security holder of Distributing.
- (c) The five years of financial information submitted for Business A conducted by Distributing through Operating is representative of the present operations and there have been no substantial operational changes since the date of the last financial statements submitted.

- (d) Neither Business A of Distributing or Controlled (in each case conducted through Operating), nor control of any entity conducting such 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 in whole or in part. Throughout the five year period ending on the date of the Distribution, Operating will have been the principal owner of the goodwill and significant assets of the business conducted by Distributing and Controlled through Operating, and Operating will continue to be the principal owner of such goodwill and significant assets following the Distribution.
- (e) Following the Contribution and Distribution, each of Distributing and Controlled will continue, through its ownership of a significant interest in the membership interests of Operating, the active conduct of its respective share of all of the integrated activities of Business A conducted by Distributing through Operating prior to the consummation of the Contribution and Distribution.
- (f) The Distribution will be carried out for the corporate business purpose of promoting management stability and resolving differences in business philosophies. The Distribution is motivated in whole or substantial part by this corporate business purpose.
- (g) The Distribution will not be used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (h) The fair market value of Controlled stock and any other consideration to be received by Founder B and Trust B in the Distribution will be approximately equal to the fair market value of Distributing stock surrendered by such shareholders in the Distribution.
- (i) The total fair market value of the assets transferred to Controlled by Distributing in the Contribution will exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of section 357(d)) by Controlled in connection with the Contribution, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the Contribution, and (iii) the amount of any cash and the fair market value of any other property (other than stock or securities permitted to be received under section 361(a) without recognition of gain) received by Distributing from Controlled in connection with the Contribution. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the Contribution.
- (j) The total adjusted basis of the assets to be transferred to Controlled by Distributing will equal or exceed the sum of the liabilities assumed (as

determined under section 357(d)) by Controlled plus any liabilities to which the transferred assets are subject. The liabilities assumed, if any, (as determined under section 357(d)) by Controlled will be incurred in the ordinary course of business and will be associated with the assets transferred.

- (k) The aggregate fair market value of the assets contributed to Controlled in the Contribution will exceed the aggregate adjusted basis of those assets.
- (l) No property will be transferred by Distributing to Controlled for which an investment credit allowed under section 46 has been or will be claimed.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (n) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (o) Payments made in connection with all continuing transactions, if any, following the Proposed Transaction between Distributing and Controlled will be made 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 Proposed Transaction are investment companies as defined in sections 368(a)(2)(F)(iii) and (iv).
- (q) Distributing and Controlled each will pay its own expenses, if any, incurred in connection with the Contribution and the Distribution.
- (r) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of 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 sections 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (s) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of 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 sections 355(d)(5) and (8)) during the five year

- period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing's stock or securities that were acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (t) The Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 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 section 355(d)(4)) in Distributing or Controlled (including any predecessor or successor to any such corporation).
 - (u) Immediately after the Distribution, neither Distributing nor Controlled will be a "disqualified investment corporation" (within the meaning of section 355(g)(2)).

RULINGS

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

- (1) The Contribution, together with the Distribution, will qualify as a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" within the meaning of section 368(b).
- (2) Distributing will not recognize any gain or loss on the Contribution. Sections 361(a) and 357(a).
- (3) Controlled will not recognize any gain or loss on the Contribution. Section 1032(a).
- (4) Controlled's basis in each asset received from Distributing in the Contribution will equal the basis of such asset in the hands of Distributing immediately before its transfer. Section 362(b).
- (5) Controlled's holding period in each asset received from Distributing in the Contribution will include the period during which Distributing held that asset. Section 1223(2).
- (6) Distributing will not recognize any gain or loss upon the distribution of Controlled stock in the Distribution. Section 361(c).

- (7) No gain or loss will be recognized by (and no amount otherwise will be included in the income of) Shareholder B and Trust B upon the receipt of shares of Controlled stock in the Distribution. Section 355(a)(1).
- (8) The basis of the Controlled stock in the hands of Shareholder B and Trust B immediately after the Distribution will, in each instance, be the same as Shareholder B and Trust B's basis in his or its Distributing stock held immediately before the Distribution, allocated in the manner described in Treas. Reg. § 1.358-2, in accordance with sections 358(a) through (c).
- (9) Each of Shareholder B and Trust B's respective holding period for the Controlled stock received in the Distribution will include Shareholder B and Trust B's respective holding period for the Distributing stock with respect to which the Distribution was made, provided that Shareholder B and Trust B hold the Distributing stock as a capital asset on the date of the Distribution. Section 1223(1).
- (10) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under section 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(2)(B). Rev. Rul. 72-320, 1972-1 C.B. 270.

CAVEATS

Except as expressly provided herein, no opinion is expressed 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 is not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the Proposed Transaction satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) whether the Proposed Transaction is used principally as a device for the distribution of the earnings and profits of Distributing, Controlled, or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); (iii) whether the Proposed Transaction 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 either Distributing or Controlled (see section 355(e)(2)(A)(ii) and Treas. Reg. § 1.355-7); and (iv) any non-arm's length transactions between any of the parties to the Proposed Transaction.

PROCEDURAL STATEMENTS

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 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,

Leah M. Thompson
Assistant to the Branch Chief, Branch 1
Office of Associate Chief Counsel (Corporate)