

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:CORP:3
PLR-132204-13
Date:
January 29, 2014

Legend

Distributing =

Controlled =

Shareholder A =

Shareholder B =

State C =

Business D =

Business E =

f =

g =

h =

Date 1 =

Date 2 =

Dear :

We respond to your July 12, 2013, request for rulings regarding certain federal income tax consequences of a proposed and partially completed transaction. The information submitted in that request and in subsequent correspondence is summarized below.

The rulings contained in this letter are based upon information 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 (described below): (i) satisfies the business purpose requirements 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 (the "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 fifty 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 State C corporation that elected to be treated as a subchapter S corporation (within the meaning of § 1361(a)(1) of the Code) on Date 1, and such election has been in effect continuously. Distributing has f shares of voting common stock outstanding. Shareholder A and Shareholder B each own g shares of Distributing stock.

Distributing conducts Business D and Business E. Shareholder A and Shareholder B estimate the fair market value of Business D to be greater than the fair market value of Business E.

To resolve shareholder conflict, the taxpayers have proposed, and partially completed, the following transaction (the "Proposed Transaction").

Proposed Transaction

1. Distributing formed Controlled, a State C corporation, on Date 2 and elected for Controlled to be a qualified subchapter S subsidiary for its first year of existence, and such election has been in effect continuously. Controlled has never been taxed as a C corporation.
2. In order to equalize the value of the Controlled stock with the value of the Distributing stock to be surrendered by Shareholder A in exchange for the Controlled stock, Shareholder B will contribute \$h to Distributing.
3. Distributing will contribute Business E and the \$h to Controlled in exchange for all f shares of the stock of Controlled (the "Controlled Contribution").
4. Distributing will distribute all of the stock of Controlled to Shareholder A in exchange for all of Shareholder A's Distributing stock (the "Distribution").

Representations

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

- (a) The fair market value of the Controlled stock and other consideration received, if any, by Shareholder A will be approximately equal to the fair market value of the Distributing stock surrendered by Shareholder A in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a Distributing shareholder.
- (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) Following the Proposed Transaction, Distributing will continue the active conduct of Business D, independently and with its own employees and/or Shareholder B and members of Shareholder B's immediate family. Following the Proposed Transaction, Controlled will continue the active conduct of Business E, independently and with its own employees and/or Shareholder A and members of Shareholder A's immediate family.
- (e) No part of Business D or Business E, nor control of any entity conducting Business D or Business E, was 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.

- (f) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to eliminate irreconcilable differences between the two shareholders of the corporation.
- (g) The Proposed Transaction is not used principally as a device for the distribution of earnings and profits of Distributing or Controlled or both.
- (h) 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.
- (i) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (j) The liabilities assumed in the Proposed Transaction and the liabilities to which the transferred assets are subject, if any, were incurred in the ordinary course of business and are associated with the assets being transferred.
- (k) The total adjusted bases of the assets transferred to Controlled by Distributing will equal or exceed the sum of the liabilities assumed (within the meaning of § 357(d)), if any, by Controlled.
- (l) The total fair market value of the assets that Distributing will transfer to Controlled will exceed the sum of: (a) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled in connection with the exchange; and (b) the amount of liabilities owed to Controlled by Distributing, if any, that are discharged or extinguished 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.
- (m) The aggregate fair market value of the assets contributed to Controlled will exceed the aggregate adjusted basis of such assets immediately after the Controlled Contribution.
- (n) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (o) 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 fifty percent or greater interest (within the

meaning of § 355(d)(4)) in Distributing and Controlled (including any predecessor or successor of any such corporation).

- (p) For purposes of § 355(d), immediately after the Distribution, no person (determined by applying § 355(d)(7)) will hold stock possessing fifty percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or fifty percent or more of the total value 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.
- (q) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing fifty percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or fifty 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 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.
- (r) Immediately after the Distribution, either (i) neither Distributing or Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)), or (ii) if any person holds a fifty percent or greater interest (within the meaning of § 355(g)(3)) in any disqualified investment corporation, such person will have held such interest in such corporation (either directly or through attribution) immediately before the Distribution.

Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows regarding the Proposed Transaction:

- (1) The Controlled Contribution and the Distribution, taken together, will constitute a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be a “party to a reorganization” within the meaning of § 368(b).
- (2) Distributing will not recognize any gain or loss on the Controlled Contribution. Sections 361(a) and 357(a).

- (3) Controlled will not recognize any gain or loss on its receipt of the assets from Distributing in exchange for Controlled stock in the Controlled Contribution. Section 1032(a).
- (4) Controlled's basis in each asset received from Distributing in the Controlled Contribution will equal the basis of that asset in the hands of Distributing immediately before the Controlled Contribution. Section 362(b).
- (5) Controlled's holding period in each asset received from Distributing in the Controlled Contribution will include the period during which Distributing held that asset. Section 1223(2).
- (6) Distributing will not recognize any gain or loss upon its distribution of the stock of Controlled to Shareholder A in the Distribution. Section 361(c).
- (7) Shareholder A will not recognize any gain or loss (and will not include any amount in income) upon receipt of Controlled stock from Distributing in the Distribution. Section 355(a)(1).
- (8) Shareholder A's aggregate basis in Controlled stock will equal the aggregate basis of the Distributing stock surrendered by Shareholder A in exchange therefore, allocated in the manner described in § 1.358-2(a)(2). Section 358(a)(1) and (b). Shareholder B's basis in Shareholder B's Distributing stock will be increased by \$h.
- (9) The holding period of the Controlled stock received by Shareholder A in the Distribution will include the holding period of the Distributing stock exchanged therefor, provided that such Distributing stock is held as a capital asset on the date of the Distribution. Section 1223(1).
- (10) Distributing's earnings and profits will be allocated between Distributing and Controlled in accordance with § 312(h) and § 1.312-10(a).
- (11) The accumulated adjustments account of Distributing will be allocated between Distributing and Controlled in a manner similar to the manner in which the earnings and profits of Distributing are allocated under § 312(h). Section 1.1368-2(d)(3).
- (12) Provided that the Distribution is undertaken immediately after the Controlled Contribution, Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B) and will not, in and of itself, render Controlled ineligible to elect to be a subchapter S corporation for its first taxable year.

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.

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, copies of this letter are being sent to your authorized representatives.

Sincerely,

Ken Cohen
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel (Corporate)

cc: