

Internal Revenue Service

Department of the Treasury
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:CORP:5
PLR-106081-19

Date:
September 10, 2019

Legend

Distributing =

Controlled =

Business A =

Business B =

Business C =

QSub 1 =

QSub 2 =

QSub 3 =

LLC 1 =

Grantor Trust 1 =

Grantor Trust 2 =

Irrevocable Trust 1 =

PLR-106081-19

2

Irrevocable Trust 2 =

Irrevocable Trust 3 =

Irrevocable Trust 4 =

Irrevocable Trust 5 =

Irrevocable Trust 6 =

Irrevocable Trust 7 =

Beneficiary 1 =

Beneficiary 2 =

Beneficiary 3 =

Beneficiary 4 =

Bank =

Continuing Relationships =

Tax Cover Price =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

State A =

Asset A =

Asset B =

Asset C =

Asset D =

a =

b =

c =

d =

e =

f =

g =

h =

i =

i =

k =

l =

m =

n =

o =

p =

q =

r =

s =

t =

Dear _____ :

This letter responds to your letter dated March 20, 2019, as supplemented on May 28, 2019 and August 1, 2019, requesting rulings under § 355 and related provisions of the Internal Revenue Code and related regulations with respect to the proposed transaction described below (the “Proposed Transaction”). The material information submitted is summarized below.

The rulings contained in this letter are based upon information submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. While this Office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This letter is issued pursuant to Rev. Proc. 2017-52, 2017-41 I.R.B. 283, as amplified and modified by Rev. Proc. 2018-53, 2018-43 I.R.B. 667, regarding one or more “Covered Transactions” under § 355 and § 368 of the Internal Revenue Code (the “Code”). This Office expresses no opinion as to the overall tax consequences of the transactions described in this letter or as to any issue not specifically addressed by the rulings below.

This office has made no determination regarding whether the Distribution (as defined 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 the distributing corporation or the controlled corporation or both (see § 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, or any predecessor or successor of the distributing corporation or the controlled corporation, within the meaning of Treas. Reg. § 1.355-8T (see § 355(e)(2)(A)(ii) and Treas. Reg. § 1.355-7).

Summary of Facts

Distributing was formed on Date 1 as a State A corporation. On Date 2, Distributing elected under § 1362(a) of the Code to be treated as a subchapter S corporation for Federal income tax purposes. Distributing is engaged in Business A, Business B, and Business C. Business A is operated by QSub 1, a State A corporation which has elected under § 1361(b)(3)(B) of the Code to be treated as a qualified subchapter S subsidiary for federal income tax purposes. Business B is operated by QSub 2, a State A limited liability corporation which has elected under § 1361(b)(3)(B) of the Code to be treated as a qualified subchapter S subsidiary for federal income tax purposes. Business C is operated by QSub 3, a State A limited liability corporation which has elected under § 1361(b)(3)(B) of the Code to be treated as a qualified subchapter S subsidiary for federal income tax purposes. Business C consists of assets including Asset A, Asset B, and Asset C. Distributing also owns a percent of LLC 1, a State A limited liability company which has elected to be disregarded for federal income tax purposes.

Distributing has both voting and non-voting shares of stock outstanding. Distributing's Series A stock represents a percent of the vote and b percent of the value. Distributing's Series B stock represents c percent of the vote and d percent of the value. Grantor Trust 1 owns e percent of the outstanding Series A stock. Grantor Trust 2 owns f percent of the outstanding Series A stock. Irrevocable Trust 1 owns g percent of the outstanding Series B stock. Irrevocable Trust 2 owns h percent of the outstanding Series B stock. Irrevocable Trust 3 owns i percent of the outstanding Series B stock. Distributing is managed and operated by the beneficiaries of Grantor Trust 1, Grantor Trust 2, Irrevocable Trust 1, Irrevocable Trust 2, and Irrevocable Trust 3.

On Date 3, Irrevocable Trust 1 elected to be treated as an electing small business trust under § 1361(e) of the Code. Irrevocable Trust 1 was created for the benefit of Beneficiary 1, Beneficiary 2, Beneficiary 3, and Beneficiary 4. Beneficiary 1, Beneficiary 2, Beneficiary 3, and Beneficiary 4 are siblings.

Beneficiary 1 is the beneficiary of Irrevocable Trust 4. Beneficiary 2 is the beneficiary of Irrevocable Trust 5. Beneficiary 3 is the beneficiary of Irrevocable Trust 6. Beneficiary 4 is the beneficiary of Irrevocable Trust 7.

Financial information has been submitted indicating that each of Business A and Business C have had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

To resolve differences of opinion among the shareholders as to how Business C should be operated, Distributing proposes the following transaction (the "Proposed Transaction"):

Proposed Transaction

To achieve the business purposes described above, the following series of steps are proposed:

1. The assets of Irrevocable Trust 1 will be divided into j equal shares and be contributed to Irrevocable Trust 4, Irrevocable Trust 5, Irrevocable Trust 6, and Irrevocable Trust 7. Irrevocable Trust 4 will receive k Series B shares of Distributing representing l percent of the outstanding Series B Shares. Irrevocable Trust 5, Irrevocable Trust 6, and Irrevocable Trust 7 will receive m Series B shares of Distributing representing n percent of the outstanding Series B Shares.
2. On Date 4, Controlled was formed as a subsidiary of Distributing. Distributing will file an election to treat Controlled as a qualified subchapter S subsidiary for federal income tax purposes under § 1361(b)(3)(B) of the Code. On Date 5, Controlled formed o State A single member limited liability companies (each a "Controlled SPE").
3. Distributing will contribute Asset A, Asset B, and Asset C (the "Contribution" and collectively, the "Controlled Business"), Asset D, and p percent of LLC 1 to Controlled in exchange for Controlled common stock and the assumption of liabilities described in Step 4. Each asset of the Controlled Business and Asset D will be transferred to a separate Controlled SPE.
4. Distributing will cause Controlled to enter into a credit agreement with Bank, which will establish a line of credit with a maximum aggregate principal amount of \$q prior to the Split-off and \$r after the Split-off (the "Controlled Credit Line"). Prior to the Split-off, Controlled will draw down \$q on the Controlled Credit Line, which will be evidenced by a promissory note (the "Controlled Loan") and the outstanding principal of Distributing's loan with Bank (the "Bank Loan") will be reduced by a corresponding amount.
5. Any obligations (not otherwise settled or resolved in other steps) that would result in obligations between Distributing immediately following the Split-off (defined below) will be settled in cash, other than obligations under the Continuing Relationships (defined below).
6. Distributing will distribute all of the Controlled common stock to Irrevocable Trust 4 in exchange for all of the shares of Series B stock of Distributing owned by Irrevocable Trust 4 (the "Split-off" or the "Distribution"). Irrevocable Trust 4 may receive a cash

distribution from Distributing equal to the Tax Cover Price, if that amount is positive, and Irrevocable Trust 4 will be required to pay the Negative Tax Cover to Distributing, if that amount is negative.

7. Contemporaneous with Step 6, Distributing will redeem for cash s shares of its Series A stock held by Grantor Trust 1 to reduce the percentage of Series A stock owned by Grantor Trust 1 to t percent of the outstanding Series A stock.
8. After the Split-off, Controlled will elect under § 1362(a) of the Code to be treated as an S corporation on the first available date, effective as of the date of the Split-off. Controlled's sole owner, Irrevocable Trust 4, will file a timely election to be treated as an electing small business trust under § 1361(e) of the Code.
9. Following the Proposed Transaction, Distributing will engage in certain continuing business relationships with Controlled, Irrevocable Trust, and Beneficiary 1 (collectively, the "Continuing Relationships"). All such relationships will be based on arm's length terms and conditions and will not be inconsistent with the overall separation of Business A and the Controlled Business.

Representations

With respect to the Distribution, except as set forth below, Distributing has made all of the representations in Section 3 of the Appendix to Rev. Proc. 2017-53, 2017-41 I.R.B. 283 in the form set forth therein .

Distributing has made the following alternative representations set forth in Section 3 of the Appendix to Rev. Proc. 2017-53:

Representations 3(a), 8(a), 11(a), 15(a), 22(a), 31(a), and 41(b)

Distributing has not made the following representations, which do not apply to the Proposed Transaction:

Representations 5, 6, 19, 20, 24, 25, 35, 36, 37, 38, 39, and 40.

In addition, except as set forth below, Distributing has made all of the representations in Section 3.04 of Rev. Proc. 2018-53, 2018-43 I.R.B. 667.

Distributing has made the following modified representation:

Representation 4: The Controlled Loan was obtained to substitute for an equivalent amount of Distributing Debt (the Bank Loan). Distributing incurred the Distributing Debt that will be satisfied with the Controlled Loan (a) before the request for any relevant ruling is submitted and (b) no later than 60 days before the earliest of the following

dates: (i) the date of the first public announcement (as defined in § 1.355-7(h)(10)) of the Divisive Reorganization or a similar transaction, (ii) the date of the entry by Distributing into a binding agreement to engage in the Divisive Reorganization or a similar transaction, and (iii) the date of approval of the Divisive Reorganization or a similar transaction by the board of directors of Distributing.

Rulings

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

1. The Split-off will cause a termination of Controlled's QSub election because Controlled will cease to be a wholly-owned subsidiary of an S corporation. For federal income tax purposes, Controlled will be treated as a new corporation acquiring all of its assets and assuming all of its liabilities from distributing immediately before the termination of Controlled's QSub election in exchange for the stock of Controlled (the Contribution), pursuant to Treas. Reg. § 1.1361-5(b)(1)(i) (§ 1361(b)(3)(B) and (C)).
2. The Contribution followed by the Split-off will qualify as a "reorganization" within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be "a party to the reorganization" within the meaning of section 368(b).
3. Distributing will recognize no gain or loss on the Contribution. Sections 357 and 361(a).
4. Controlled will recognize no gain or loss on the Contribution. Section 1032(a).
5. Controlled's basis in each asset received in the Contribution will be the same as the basis of that asset in the hands of Distributing immediately prior to the Contribution. Section 362(b).
6. Controlled's holding period in each asset received in the Contribution will include the period during which Distributing held such asset. Section 1223(2).
7. Distributing will recognize no gain or loss on the Split-off. Section 361(c)(1).
8. Irrevocable Trust 4 will recognize no gain or loss (and no amount will be includable in its income) on the receipt of the stock of Controlled in the Split-off. Section 355(a).
9. The basis of the Controlled stock in the hands of Irrevocable Trust 4 immediately after the Split-off will be the same as the basis of the Distributing stock held by Irrevocable Trust 4 immediately before the Split-off. Section 358(a)(1).

10. Irrevocable Trust 4's holding period of the Controlled stock received in the Split-off will include the holding period of Irrevocable Trust 4's Distributing stock exchanged, provided that Irrevocable Trust 4 holds such Distributing stock as a capital asset on the date of the Split-off. Section 1223(1).
11. As provided in section 312(h), proper allocation of earnings and profits among Distributing and Controlled will be made in accordance with Treas. Reg. § 1.312-10(a).
12. Distributing's accumulated adjustments account immediately before the transaction will be allocated between Distributing and Controlled in a manner similar to the manner in which earnings and profits are allocated under § 312(h) in accordance with Treas. Reg. § 1.1368-2(d)(3) (§§ 1.312-10(a) and 1.1368-2(d)(3)).
13. Momentary ownership by Distributing of the stock of Controlled, as part of the reorganization, will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). Controlled may, without requesting the Commissioner's consent, make a valid S corporation election before the expiration of the five-year period described in section 1361(b)(3)(D) and Treas. Reg. § 1.1361-5(c)(1), provided that (i) immediately following the distribution of the Controlled stock, Controlled is otherwise eligible to make an S corporation election, and (ii) the election is made effective on the date of the Split-off.
14. Payments made by and between Distributing and Controlled under the Continuing Relationships regarding liabilities, indemnities, or other obligations that (i) relate to periods ending on or before the Split-off, and (ii) do not become fixed and ascertainable until after the Split-off, will be treated as occurring immediately before the Split-off. See *Arrowsmith v. Commissioner*, 344 U.S. 6, 8 (1952); Rev. Rul. 83-73, 1983-1 C.B. 84.
15. Payments of Tax Cover Price made by Distributing to Irrevocable Trust 4 and payments of Negative Tax Cover Price made by Irrevocable Trust 4 to Distributing that do not become fixed and ascertainable until after the Split-off, will be treated as occurring immediately before the Split-off. See *Arrowsmith v. Commissioner*, 344 U.S. 6, 8 (1952); Rev. Rul. 83-73, 1983-1 C.B. 84.

Caveats

Except as expressly provided herein, no opinion is expressed or implied concerning the tax treatment of the proposed transactions under any provision of the Code and regulations or the tax treatment of any condition existing at the time of, or effects resulting from, the Proposed Transaction that is not specifically addressed by this letter.

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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Mark S. Jennings
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel (Corporate)

cc: