

**Internal Revenue Service**

Department of the Treasury  
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Person To Contact:

ID No.

Telephone Number:

Refer Reply To:  
CC:CORP:B2  
PLR-126886-20

Date:  
May 20, 2021

**Legend**

Distributing =

Controlled =

Sub 1 =

PRS 1 =

PRS 2 =

PRS 3 =

PRS 4 =

DRE 1 =

DRE 2 =

DRE 3 =

DRE 4 =

DRE 5 =

Individual A =

Business A =

Business B =

a =

b =

c =

d =

e =

f =

g =

h =

Date 1 =

Date 2 =

Date 3 =

Transition  
Agreement =

Employee  
Transfer  
Agreement =

Dear :

This letter responds to your authorized representatives' letter dated October 26, 2020, as supplemented by subsequent information and documentation, requesting rulings on certain federal tax consequences of a series of transactions (the "Completed Transaction," as defined below). The material information submitted in that letter and subsequent correspondence is summarized below.

This letter is issued pursuant to Rev. Proc. 2017-52, 2017-41 I.R.B. 283, regarding one or more "Covered Transactions" under sections 355 and 368 of the Internal Revenue Code (the "Code"). This Office expresses no opinion as to any issue not specifically addressed by the rulings below.

The rulings contained in this letter are based upon facts and representations submitted by the taxpayer and accompanied by a penalties 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.

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

### Summary of Facts

Distributing is a subchapter S corporation. Individual A owns a% of the stock of Distributing; unrelated shareholders own the remaining stock of Distributing. Individual A also owns b% of the stock of Sub 1, a domestic corporation; unrelated shareholders own the remaining stock of Sub 1.

Distributing and an unrelated person (as limited partners) respectively own c% (an amount greater than 33 1/3%) and d% of the interests in PRS1, a domestic eligible entity (within the meaning of Treas. Reg. § 301.7701-3(a)) that is classified as a partnership for federal income tax purposes (an “eligible entity classified as a partnership”). Sub 1 (as a general partner) owns the remaining interest in PRS 1.

PRS 1 owns all of the interests in DRE 1, a domestic eligible entity that is disregarded as separate from its owner for federal income tax purposes (a “disregarded entity”). DRE 1 (as a limited partner) owns an e% interest in PRS 2, a domestic eligible entity classified as a partnership; Sub 1 (as a general partner) owns the remaining interest in PRS 2.

PRS 1 also owns all of the interests in DRE 2, a domestic disregarded entity. DRE 2 owns a f% interest in PRS 3, a domestic eligible entity classified as a partnership; unrelated shareholders own the remaining interests in PRS 3. PRS 3 owns all the interests in DRE 3, a domestic disregarded entity. DRE 3 owns all the interests in DRE 4, a foreign disregarded entity.

Prior to Date 2, PRS 1 owned an e% interest in PRS 4, a domestic eligible entity classified as a partnership (an amount resulting in Distributing indirectly owning a greater than 33 1/3% interest in PRS 4); Sub 1 owned the remaining interest in PRS 4. PRS 4 owns all the interests in DRE 5, a domestic disregarded entity.

Through its direct and indirect ownership of PRS 1 and PRS 4, Distributing is engaged in Business A and Business B. PRS 1 is engaged in Business A through PRS 2, PRS 3, DRE 1, DRE 2, DRE 3, and DRE 4. PRS 4 is engaged in Business B through DRE 5.

Financial information has been submitted in accordance with Rev. Proc. 2017-52 indicating that each of Business A and Business B has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

### Completed Transaction

For what are represented to be valid corporate business purposes, Distributing undertook the Completed Transaction to separate Business A from Business B.

The steps of the Completed Transaction are set forth below:

- (i) Distributing formed Controlled, effective Date 1.
- (ii) Distributing filed an election under section 1361(b)(3)(B) of the Code to treat Controlled as a qualified subchapter S subsidiary for federal income tax purposes (the "QSub election"), effective Date 1.
- (iii) On Date 2, PRS 1 distributed all of its interests in PRS 4 pro rata to Distributing and its other partners in a distribution that qualified under section 731(a) and (b) of the Code.
- (iv) On Date 2, Distributing contributed all of its interests in PRS 4 to Controlled (the "Contribution").
- (v) On Date 2, Distributing distributed all the stock of Controlled pro rata to its shareholders (the "Distribution").
- (vi) On Date 3, Controlled elected under section 1362(a) of the Code to be treated as a subchapter S corporation for federal income tax purposes effective immediately following the termination of the QSub election.

In connection with the Completed Transaction, Distributing and Controlled entered into certain business arrangements, including a Transition Services Agreement and an Employee Transfer Agreement (collectively, the "Continuing Relationships"). The Transition Services Agreement is expected to terminate within g months of the Distribution, whereas the Employee Transfer Agreement is expected to terminate within h months of the Distribution.

### **Representations**

With respect to the Distribution, except as otherwise set forth below, Distributing has made all the representations in section 3 of the Appendix to Rev. Proc. 2017-52.

Distributing has made the following alternative representations:

Representations 3(a), 8(a), 11(a) (except as noted in the Continuing Relationships), 15(a), 22(a), 31(a), and 41(b).

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

Representations 7, 17, 19, 20, 24, 25, 35, 36, 37, 38, 39, 40, and 43.

Additionally, Distributing has represented that the pro rata distribution by PRS 1 of all of its interests in PRS 4 to Distributing and its other partners qualified under section 731(a) and (b) of the Code.

### **Rulings**

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

1. The Distribution caused a termination of Controlled's QSub election because Controlled ceased 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 Distributing's PRS 4 equity from Distributing immediately before the termination of Controlled's QSub election in exchange for the stock of Controlled (i.e., the Contribution). Treas. Reg. § 1.1361-5(b)(1)(i) (section 1361(b)(3)(B) and (C)).
2. The Contribution and the Distribution, together, will be a "reorganization" within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" within the meaning of section 368(b).
3. Distributing will not recognize gain or loss on the Contribution. Sections 361(a) and 357(a).
4. Controlled will not recognize 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 such asset in the hands of Distributing immediately before 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 the asset. Section 1223(2).
7. Distributing will not recognize gain or loss on the Distribution. Section 361(c).
8. Distributing's shareholders will not recognize gain or loss (and no amount will be includable in income) upon receipt of Controlled stock in the Distribution. Section 355(a).
9. The aggregate basis of the Controlled stock and the Distributing stock in the hands of each shareholder immediately after the Distribution will equal the aggregate basis of the Distributing stock held by the shareholder immediately before the Distribution, allocated between the stock of Controlled and Distributing

in proportion to the fair market value of each immediately following the Distribution in accordance with Treas. Reg. § 1.358-2(a). Section 358(a)(1) and (b).

10. Each shareholder's holding period in the Controlled stock received in the Distribution will include the holding period of the Distributing stock, provided that the Distributing stock is held as a capital asset on the date of the Distribution. Section 1223(1).
11. Earnings and profits, if any, will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. § 1.312-10(a).
12. Distributing's accumulated adjustments account will be allocated between Distributing and Controlled in a manner similar to the manner in which the earnings and profits of Distributing would be allocated under section 312(h) in accordance with Treas. Reg. § 1.1368-2(d)(3).
13. Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under section 368(a)(1)(D), did not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B), and did not, in itself, render Controlled ineligible to elect to be an S corporation for its first taxable year. If Controlled otherwise meets the requirements of a small business corporation under section 1361, Controlled will be permitted to make a subchapter S election under section 1362(a) for its first taxable year, provided that such election is made effective immediately following the termination of the QSub election.

### **Caveats**

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in 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.

In accordance with the power of attorney on file with this Office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

*Susan E. Massey*  
Susan E. Massey  
Branch Chief, Branch 3  
Office of Associate Chief Counsel (Corporate)

cc: