



Distributing  
Assets =

Controlled  
Assets =

Dear :

This letter responds to your authorized representative's letter dated December 30, 2021, requesting rulings on certain U.S. federal income tax consequences of a proposed transaction (described below) (the Proposed Transaction). The information provided in that request and in later correspondence is summarized below.

This letter is issued pursuant to Rev. Proc. 2017-52, 2017-42 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 on 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 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.

This Office has made no determination regarding whether the Proposed Transaction: (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 State A corporation that was formed on Date 1. Distributing made an election under section 1362(a) to be a subchapter S corporation effective as of Date 2. Distributing has a single class of common stock that is owned as follows: Shareholder A owns a%; Shareholder B and Shareholder C together own a%. Collectively, Shareholder A, Shareholder B, and Shareholder C are referred to as the “Shareholders.”

Shareholder A and Shareholder B are siblings. Shareholder B and Shareholder C are spouses. Shareholder A is the President of Distributing. Shareholder B and C are officers and directors of Distributing. The Shareholders manage and operate Distributing and are Distributing’s sole employees.

Distributing is a calendar year taxpayer and uses the cash method of accounting. Distributing is directly engaged in Business A. The financial information submitted in accordance with Rev. Proc. 2017-52 by Distributing indicates that Distributing has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

### **Proposed Transaction**

The Shareholders have serious disagreements about how to best manage Business A and desire to split the assets and operate separate portions of Business A independently. Therefore, Distributing has proposed the following Proposed Transaction:

- (i) Distributing will form Controlled as a State A corporation. Controlled will have one class of stock outstanding.

- (ii) Distributing will transfer the Controlled Assets to Controlled in exchange for all of the Controlled stock and the assumption by Controlled of the liabilities associated with the transferred assets (the "Contribution").
- (iii) Distributing will distribute all of the stock of Controlled to Shareholder A in exchange for all of Shareholder A's stock in Distributing (the "Distribution").
- (iv) Immediately after the Distribution, Controlled will make an election under section 1362(a) to be treated as a subchapter S corporation and will have one class of stock outstanding. Controlled will use the cash method of accounting.

### **Representations**

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

1. Distributing has made the following alternative representations:

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

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

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

### **Rulings**

1. The Contribution and Distribution, together, will constitute 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).
2. Distributing will not recognize gain or loss on the Contribution. Sections 361(a) and 357(a).
3. Controlled will not recognize 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 that asset in the hands of Distributing immediately before the Contribution. 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 gain or loss on the Distribution. Section 361(c).
7. Shareholder A will not recognize gain or loss (and no amount will otherwise be included in income) upon receipt of the Controlled stock. Section 355(a).
8. Shareholder A's basis in the Controlled stock immediately after the Distribution will equal Shareholder A's basis in the Distributing stock surrendered in the Distribution and will be allocated among the shares received in the manner described in Treas. Reg § 1.358-2(a). Section 358(a)(1) and (b).
9. Shareholder A's holding period in the Controlled stock received in the Distribution will include the holding period of the Distributing stock surrendered in the Distribution, provided that the Distributing stock is held as a capital asset in the hands of Shareholder A on the date of the Distribution. Section 1223(1).
10. Distributing's accumulated adjustment account immediately before the transaction will be allocated between Distributing and Controlled in a manner similar to the manner in which Distributing's earnings and profits will be allocated under section 312(h) in accordance with Treas. Reg. § 1.1368-2(d)(3). Treas. Reg. §§ 1.312-10(a) and 1.1368-2(d)(3).
11. Distributing's momentary ownership of the stock of the 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)(1)(B), and will not, in itself, render Controlled ineligible to elect to be a subchapter S corporation for its first taxable year. If Controlled otherwise meets the requirements of a small business corporation under section 1361, Controlled will be eligible to make a subchapter S election under section 1362(a) for its first taxable year, provided that such election is made effective immediately upon the Distribution.

### **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 transactions that are not specifically addressed 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, a copy of this letter is being sent to your authorized representatives.

Sincerely,

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William W. Burhop  
Senior Technician Reviewer, Branch 5  
Office of the Associate Chief Counsel  
(Corporate)