

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

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**December 14, 1998**

Distributing =

Controlled I =

Controlled II =

Controlled III =

Controlled IV =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

State X =

Year =

Dear :

This is in response to a letter dated February 16, 1998, requesting certain rulings under § 355 of the Internal Revenue Code. Additional information has been submitted in letters dated September 2, 1998; October 5, 1998; October 28, 1998; November 3, 1998; December 2, 1998; and December 10, 1998.

The rulings contained in this letter are predicated upon facts and representations submitted by your authorized representatives and accompanied by a penalties of perjury statement executed by you. This office has not verified any of the material submitted in support of this request for ruling. Verification of the factual information, representations, and other data may be required as part of the audit process. The information submitted for our consideration is summarized as follows.

Distributing, a State X cash basis corporation, has been engaged in the farming business for more than five years. Distributing elected to be taxed as an S corporation for federal income tax purposes in Year. It files its returns on a calendar year basis. Distributing is currently owned equally by five shareholders, Shareholders 1, 2, 3, 4 and 5. Each shareholder owns an equal number shares of stock of Distributing. Distributing is in the business of farming, and has been engaged in all aspects of this business. Distributing is currently growing wheat, corn and soy bean on its lands but has grown other crops in the past.

Over the years, the shareholders of Distributing have differed on a number of business issues including what crops to grow, the proper marketing strategy for Distributing, as well as the management of the farm labor. In addition, the shareholders have disagreed on whether the business should be expanded and what types of financing should be used to expand the business. Due to these continuing shareholder disputes, which have disrupted the business of Distributing, the shareholders of Distributing have decided to separate the business of Distributing in the following manner:

- (1) Distributing will form Controlled I, II, III and IV, and will initially receive all of the outstanding shares of each Controlled, respectively, in exchange for real estate and equipment of Distributing necessary for the operation by each Controlled of a farming business.
- (2) Distributing will distribute the shares of stock of Controlled I, II, III and IV, respectively, to Shareholder 1, 2, 3 and 4, respectively in exchange for all of their shares of Distributing stock. Shareholder 5 will be the sole remaining shareholder of Distributing.

The taxpayer has supplied financial information which indicates that Distributing has been conducting a business that has had gross receipts and operating expenses representative of the active conduct of the business for each of the past five years.

The following representations have been made in connection with the transaction:

- (a) There will be no debt outstanding between Distributing and any Controlled after the proposed transaction.
- (b) The fair market value of the stock of the Controlled corporation to be received by each shareholder of the Distributing corporation will be equal to the fair market value of the Distributing corporation stock surrendered by such shareholder in the exchange.
- (c) No part of the consideration received by Distributing is being received by a shareholder as a creditor, employee or in any capacity other than that as a shareholder of Distributing.
- (d) The five years of financial information submitted on behalf of the Distributing corporation 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.
- (e) Following the transaction, the Distributing and each Controlled corporation will each continue, independently and with its separate employees, the active conduct of all of the integrated activities of the business conducted by the Distributing corporation prior to the consummation of the transaction.
- (f) The distribution of stock of the Controlled corporation is carried out for the following corporate business purposes: (i) resolution of shareholder disputes and (ii) allowing the individual shareholders to separately manage their respective businesses. The distribution of the stock of the Controlled corporation is motivated in whole or in substantial part by one or more of these corporate business purposes.
- (g) Distributing corporation is an S corporation (within the meaning of § 1361(a) of the Internal Revenue Code). Each Controlled corporation will elect to be an S corporation pursuant to § 1362(a) on the first available date after the distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of either the Distributing or each of the Controlled corporations.
- (h) There is no plan or intention by the shareholders of the Distributing corporation to sell, exchange or transfer by gift or otherwise dispose of any of their stock in either the Distributing or any Controlled corporation after the transaction.

- (i) There is no plan or intention by either Distributing or any of the Controlled corporations, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction other than through stock purchases meeting the requirements of § 4.05(1)(B) of Rev. Proc. 96-30.
- (j) Distributing and each Controlled corporation have no accumulated earnings and profits at the beginning of their respective taxable years.
- (k) Distributing and each Controlled corporation will have no current earnings and profits as of the date of the distribution.
- (l) No distribution of property by Distributing immediately before the transaction would require recognition of gain resulting in current earnings and profits for the taxable year of the distribution.
- (m) Distributing is not aware of, nor is Distributing planning or intending, any event that will result in Distributing or any of the Controlled corporations having positive current or accumulated earnings and profits after the distribution.
- (n) There is no plan or intention to liquidate either Distributing or any of the Controlled corporations, to merge any of the corporations with any corporation, or to sell or otherwise dispose of the assets of any corporation after the transaction except in the ordinary course of business.
- (o) The total adjusted basis and fair market value of the assets transferred to each Controlled corporation by Distributing each equals or exceeds the sum of the liabilities assumed by each Controlled corporation plus any liabilities to which the transferred assets are subject. The liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (p) The income tax liability for the taxable year in which the investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47), as in effect before amendment by Public Law 101-508, Title 11, 104 STAT. 1388, 536 (1990), if applicable, to reflect an early disposition of property.
- (q) No intercorporate debt will exist between the Distributing corporation and each Controlled corporation at the time of, or subsequent to, the distribution or the Controlled corporation's stock.
- (r) Payments made in connection with all continuing transactions, if any, between Distributing and any Controlled corporation, or between the Controlled corporations, will be for fair market value based on terms and conditions arrived at by the parties

bargaining at arm's length.

(s) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(ii) and (iv).

(t) The distribution is not part of a plan or series of related transactions (within the meaning of section 355(e)) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing, Controlled I, Controlled II, Controlled III and Controlled IV, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing, Controlled I, Controlled II, Controlled III and Controlled IV.

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

- (1) The transfer by Distributing to each of Controlled I, II, III and IV of a portion of the assets and liabilities of its farming business followed by the distribution of stock of each of Controlled I, II, III and IV, respectively, to each of shareholders 1, 2, 3 and 4, respectively, will each be a reorganization within the meaning of § 368(a)(1)(D). Distributing and each Controlled will each be a "party to the reorganization" within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing upon the transfer of assets to each Controlled and the assumption of liabilities by each Controlled in exchange for the stock of each Controlled. § 361(a) and § 357(a).
- (3) No gain or loss will be recognized by each Controlled upon the receipt of the assets from Distributing in exchange for shares of stock of such Controlled. § 1032(a).
- (4) The basis of the assets received by each of Controlled I, II, III and IV will be the same as the basis of such assets in the hands of Distributing immediately prior to their transfer to such Controlled. § 362(b).
- (5) The holding period of the Distributing assets received by each Controlled will include the period during which such assets were held by Distributing. § 1223(2).
- (6) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholders 1, 2, 3 and 4, respectively, upon their receipt of the shares of Controlled I, II, III and IV stock, respectively, in exchange for all of their Distributing shares, as described above. § 355(a)(1).
- (7) No gain or loss will be recognized to Distributing upon the distribution of the

Controlled I, II, III and IV stock, respectively, to Shareholders 1, 2, 3 and 4, as described above. § 361(c).

- (8) The basis of the stock of each Controlled in the hands of its respective shareholder will be the same as the basis of the Distributing stock surrendered by the shareholder in exchange therefor. § 358(a)(1).
- (9) The holding period of the stock of each Controlled corporation received by its respective shareholder will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset on the date of the distribution. § 1223(1)
- (10) The momentary affiliation by Distributing of the stock of Controlled in connection with the reorganization will not, in and of itself, make each of Controlled ineligible to elect to be an S corporation for its first tax year, provided that each of Controlled otherwise meets the other requirements under § 1361(b).
- (11) Proper allocation of earnings and profits between Distributing and each Controlled corporation will be made under § 312(h) and § 1.312-10(a) of the Income Tax Regulations.
- (12) Controlled I, Controlled II, Controlled III and Controlled IV will be subject to § 1374 with respect to any asset transferred to Controlled I, Controlled II, Controlled III and Controlled IV to the same extent Distributing was subject to § 1374 with respect to such asset. For purposes of § 1374, the recognition period for Controlled I, Controlled II, Controlled III and Controlled IV will be reduced by the portion of Distributing's recognition period that expired prior to the transfer of these assets to Controlled I, Controlled II, Controlled III and Controlled IV. § 1374(d)(8).

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transactions that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6610(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this ruling is consummated.

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Sincerely Yours,

Assistant Chief Counsel (Corporate)

By \_\_\_\_\_  
Howard W. Staiman  
Assistant to the Branch Chief  
CC:DOM:CORP:1