

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

**CC:CORP:B05 - PLR-107937-00**

Date:

August 7, 2000

In Re:

Distributing =

Controlled =

Business A =

Business B =

Shareholder =

State X =

Dear :

We are responding to your letter dated March 27, 2000, in which rulings are requested regarding the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated June 8, July 28, and August 4, 2000. The information submitted is summarized below.

Distributing is a State X corporation engaged in Business A. All of Distributing's outstanding shares of common stock are held by Shareholder. Distributing made an election to be treated as an S corporation for federal income tax purposes.

Controlled is a State X corporation newly formed for purposes of this transaction to engage in Business B. All of Controlled's outstanding shares of common stock are held by Distributing. Controlled will elect to be an S corporation on the first available date after the proposed distribution, described below.

The taxpayer has provided sufficient substantiation of the business reasons for the proposed separation of Business A and Business B. In accordance therewith,

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Distributing will distribute all of its shares of Controlled stock pro rata to its sole shareholder.

### **The Representations**

The taxpayer has made the following representations with respect to the transaction described above:

- (a) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (b) The indebtedness owed by Controlled to Distributing after the distribution will not constitute stock or securities.
- (c) 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.
- (d) The five years of financial information submitted on behalf of Distributing, including the assets and operations to be transferred to Controlled, is representative of that corporation's present operation, and, with regard to such corporation, except as disclosed, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Distributing is an S corporation (within the meaning of §1361(a) of the Internal Revenue Code). Controlled 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 Distributing or Controlled.
- (g) Following the transaction, Distributing and Controlled each will continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior to consummation of the transaction.
- (h) The distribution of the stock of Controlled is carried out for the following corporate business purposes: To achieve substantial savings in its cost of carrying insurance. The distribution of the stock, or stock and securities, of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (i) There is no plan or intention by the shareholder or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the

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transaction.

- (j) There is no plan or intention by either Distributing or Controlled, 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 section 4.05(1)(b) of Revenue Procedure 96-30.
- (k) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (l) Payments made in connection with all continuing transactions between Distributing and Controlled, if any, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (m) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv).
- (p) The distribution of Controlled stock is not part of a "plan or series of related transactions", within the meaning of §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 or Controlled.

The income tax liability for the taxable year in which investment credit property (including any building to which §47(d) applies) is transferred will be adjusted pursuant to §50(a)(a) 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 the property.

- (q) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (s) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under §357(d)) by Controlled.
- (t) The liabilities assumed (as determined under §357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

### **Rulings**

Based solely on the information submitted and on the representations set forth

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above, we hold as follows:

- (1) The transfer by Distributing to Controlled of the assets, in exchange for the stock of Controlled and the assumption of certain liabilities, followed by the distribution of all of the stock of Controlled to Shareholder will qualify as a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled will each be a “party to a reorganization” within the meaning of §368(b).
- (2) No gain or loss will be recognized by Distributing upon the transfer of the assets to Controlled solely in exchange for stock of Controlled and the assumption of liabilities (§§361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled upon the receipt of the assets in exchange for the stock of Controlled (§1032).
- (4) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of Controlled to Shareholder (§361(c)(1)).
- (5) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately before their transfer to Controlled (§362(b)).
- (6) The holding period of the assets transferred to Controlled will include the period during which such assets were held by Distributing (§1223(2)).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Shareholder upon receipt of the Controlled stock (§355(a)(1)).
- (8) The basis of the stock of Controlled and Distributing in the hands of Shareholder after the distribution will be the same as the aggregate basis of the Distributing stock held immediately before the distribution, allocated in proportion to the fair market value of each in accordance with §1.358-2(a)(2) of the Income Tax Regulations (§358(a)(1)).
- (9) The holding period of the Controlled stock received by Shareholder will include the holding period of the Distributing stock with respect to which the distribution was made, provided Shareholder held such stock as a capital asset on the date of the transaction (§1223(1)).
- (10) As provided in §312(h), following distribution of the stock of Controlled, proper allocation of earnings and profits will be made between Distributing and Controlled in accordance with §1.312-10(a) of the Income Tax Regulations.

**Caveats**

We express no opinion 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 transaction that are not specifically covered by the above rulings.

**Procedural Matters**

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to the taxpayer's authorized representative.

Sincerely yours,  
Associate Chief Counsel (Corporate)

By: Filiz A. Serbes  
Assistant to the Chief, Branch 5