

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:P&SI:7-PLR-106741-00
Date:
October 24, 2000

LEGEND:

Company =

a =

Corporation 1 =

Corporation 2 =

b =

c =

d =

e =

f =

g =

h =

Corporation 3 =

Merger Consideration =

A =

B =

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C =
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Dear Sir or Madam:

In a letter, dated _____, you requested a ruling concerning the proper timing of adjustments to the basis of shareholders' stock in Company under § 1367 of the Internal Revenue Code. This letter responds to your request.

The information submitted and the representations made are summarized as follows: Company, an S corporation, was organized in a to facilitate the acquisition of certain assets from Corporation 1, which was merged with and into Corporation 2 on b. Prior to the merger of Corporation 1 into Corporation 2, Corporation 1 contributed all of its other assets to Company and distributed all of Company's stock to the shareholders of Corporation 1 (the Spin-off) in a series of transactions that qualified under §§ 368(a)(1)(D), 355, and 368(a)(1)(A). A private letter ruling was obtained confirming the tax consequences. Corporation 1 has been an S corporation since its taxable year

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beginning c and Company has satisfied the ten-year period of § 1374 for any sales of Company's assets.

Company currently has approximately d of accumulated subchapter C earnings and profits (relating back to the period when Corporation 1 was a C corporation) allocated to Company from Corporation 1 as a result of the Spin-off. In addition, Company's accumulated adjustments account (AAA) was approximately e as of f.

On g, the Board of Directors of Company adopted a plan of complete liquidation for Company (the Plan). The shareholders of Company approved the Plan on h. The Plan is intended to constitute a plan of complete liquidation under § 331, and the distributions under the Plan are to be distributions in complete liquidation of Company for all federal income tax purposes.

The Plan for complete liquidation is to be effected by the implementation of the following transactions:

(1) The consummation of the transactions contemplated by certain Assets Purchase Agreements;

(2) Company's distribution to the shareholders, or to a limited liability company (the "LLC") owned by the shareholders in the same proportion as they own shares of Company, of all of the net cash proceeds from the Asset Sales and certain other assets of Company that do not relate specifically to any of Company's business divisions; and

(3) (a) The merger of Company with and into a subsidiary of Corporation 3. The merger is expected to be treated for all income tax purposes as a sale by Company of all of its assets to Corporation 3 in exchange for the Merger Consideration and the assumption by Corporation 3 of the liabilities of Company followed by a final liquidating distribution by Company to the shareholders and/or LLC of the Merger Consideration or any right thereto in a complete liquidation of Company pursuant to the merger; or

(b) If the merger does not occur, any other legal actions that would result in a complete liquidation of Company (including a merger of Company with and into the LLC).

At the time it adopted the Plan, Company consisted of four business units: the A business, the B business, the C business, and the D business. The A business consisted of the E, F, and G Divisions. The B business consisted of the H and I Divisions. The C business consisted of the J and K Divisions. The D business consisted of a D site called L.

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In anticipation of adopting the Plan, Company entered into the following agreements (the “Asset Purchase Agreements”) pursuant to which the assets of all its Divisions (other than the H Division, which is the subject of the Merger Agreement) have been or will be sold (the “Asset Sales”):

(1) The Asset Purchase Agreement by and between Company and M, dated i, pursuant to which Company will sell the E Division to M for j plus the assumption of liabilities;

(2) The Asset Purchase Agreement by an between Company and N, dated k, pursuant to which Company, on l, sold the G Division to N for m plus the assumption of liabilities;

(3) The Asset Purchase Agreement by and between Company and O, dated n, pursuant to which Company, on o, sold the F Division to O for p plus assumption of liabilities;

(4) The Share Purchase Agreement by and among Company, P, and Q, dated q, as amended by a letter agreement, dated r, pursuant to which Company, on s, sold the stock of Q to P for t;

(5) The Asset Purchase Agreement by and between Company and R, dated u, pursuant to which company, on v, sold the K Division to R for w plus assumption of liabilities; and

(6) The Asset Purchase Agreement by and between Company and S, dated x, pursuant to which Company will sell the I Division to S for y plus the assumption of liabilities.

On z, Company also entered into the Merger Agreement, pursuant to which Company will merge in a taxable transaction with and into a wholly-owned subsidiary of Corporation 3 in exchange for the Merger Consideration.

Under the terms of the Merger Agreement, all Assets Sales must be completed before the merger so that Corporation 3 will not acquire any of the operations that are committed to be sold pursuant to the Asset Purchase Agreement. The Merger Agreement provides that if, among other things, all the conditions to closing the Merger are satisfied by aa, except for the consummation of the Asset Sales (or if by bb, Company does not have a reasonable expectation of consummating all of the Asset Sales on or before aa), Corporation 3 can elect to require Company to sell all of the assets of the H Division to Corporation 3 for the same consideration pursuant to an asset purchase agreement rather than pursuant to the merger.

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Pursuant to the Plan, Company has distributed to the shareholders the proceeds of the Asset Sales that have been completed. Company contemplates that it will distribute to the shareholders the net proceeds of the sales of Company's remaining Divisions as liquidating distributions from time to time after the sales close. As a result, it is anticipated that the shareholders will receive one or more liquidating distributions in each year that the complete liquidation of Company continues until the final liquidating distributions.

Taxpayer represents that as of f, the shareholders' aggregate basis in their Company stock was approximately e and each shareholder's annual accounting period is the calendar year.

You requested a ruling on behalf of Company that for purposes of determining the amount of gain or loss to be recognized by a shareholder on the receipt of any liquidating distribution made during a taxable year, such shareholder's basis in Company's stock will be determined after giving effect to the adjustments provided in § 1367(a) for such taxable year, including any adjustments to take into account the gains recognized by Company pursuant to the sales of its Divisions.

Section 1366(a) provides that in determining the tax under chapter 1 of a shareholder for the shareholder's taxable year in which the taxable year of the S corporation ends (or for the final taxable year of a shareholder who dies, or of a trust or estate which terminates before the end of the corporation's taxable year), there shall be taken into account the shareholder's pro rata share of the corporation's—

(A) items of income (including tax-exempt income), loss, deduction, or credit the separate treatment of which could affect the liability for tax of any shareholder, and

(B) nonseparately computed income or loss.

Section 1366(b) provides that the character of any item included in a shareholder's pro rata share under § 1.1366(a)(1) is determined as if the item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation.

Section 1367(a)(1) provides that the basis of each shareholder's stock in an S corporation shall be increased for any period by the sum of the following items determined with respect to that shareholder for such period:

(A) the items of income described in § 1366(a)(1)(A),

(B) any nonseparately computed income determined under §1366(a)(1)(B), and

(C) the excess of the deductions for depletion over the basis of the property subject to depletion.

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Section 1367(a)(2) provides that the basis of each shareholder's stock in an S corporation shall be decreased for any period (but not below zero) by the sum of the following items determined with respect to the shareholder for such period:

(A) distributions by the corporation which were includible in the income of the shareholder by reason of § 1368,

(B) the items of loss and deduction described in § 1366(a)(1)(A),

(C) any nonseparately computed loss determined under §1366(a)(1)(B),

(D) any expense of the corporation not deductible in computing its taxable income and not properly chargeable to capital account, and

(E) the amount of the shareholder's deduction for depletion for any oil and gas property held by the S corporation to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such shareholder under § 613A(c)(11)(B).

Section 1.1367-1(d) provides that the adjustments described in § 1367(a) to the basis of a shareholder's stock are determined as of the close of a corporation's taxable year, and the adjustments are generally effective as of that date. However, if a shareholder disposes of stock during the corporation's taxable year, the adjustments with respect to that stock are effective immediately prior to the disposition.

Section 1368 prescribes for the tax treatment of distributions of property made by an S corporation with respect to its stock to which (but for § 1368) § 301 would apply.

Section 1371 provides that except as otherwise provided, and except to the extent inconsistent with subchapter S, subchapter C shall apply to an S corporation and its shareholders.

Section 301 in general prescribes rules for the tax treatment of a distribution of property made by a corporation to a shareholder with respect to its stock.

Section 331 provides that amounts received by a shareholder in a distribution in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. Section 301 does not apply to any distribution of property (other than a distribution referred to in § 316(b)(2)(B)), in complete liquidation.

Section 1.331-1(b) provides that the gain or loss to a shareholder from a distribution in partial or complete liquidation is determined under § 1001 by comparing the amount of the distribution with the cost or other basis of the stock.

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Based on the information submitted and the representations made, and provided that the shareholders' receipt of the proceeds from Company's sales of its Divisions is treated as full payment to the shareholders in return for their stock in Company under § 331(a), we conclude that for purposes of determining the amount of gain or loss recognized by a shareholder on receipt of any liquidating distribution made during a taxable year, the shareholder's basis in Company's stock will be determined after giving effect to the adjustments provided in § 1367(a) for that taxable year, including any adjustments to take into account the gains recognized by Company pursuant to the sales of its Divisions.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provision of the Code. In particular, we express or imply no opinion whether the shareholders' receipt of the proceeds from Company's sale of its Divisions is treated as full payment to the shareholders in return for their stock in Company under § 331(a).

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

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely yours,
Christine E. Ellison, Chief, Branch 7
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)