

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:2-PLR-114859-02
Date:
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LEGEND

Distributing =

Controlled1 =

Controlled2 =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Business A =

Business B =

Business C =

State A =

Date A =

Date B =

Date C =

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Year 1 =

Year 2 =

a =b =c =d =e =

Dear

This letter is in response to your letter of Date A requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was received in letters of Date B and Date C. The pertinent information submitted is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

SUMMARY OF FACTS

Distributing is a State A corporation which incorporated in Year 1 and elected S status effective for Year 2. Distributing has issued and outstanding a shares which are held by b related shareholders. Distributing is engaged in Businesses; A, B, and C.

Distributing's b shareholders are each responsible for one of the businesses conducted by Distributing. Shareholder A owns c shares of Distributing and manages Business A. Shareholder B owns d shares of Distributing and manages Business B. Shareholders C and D each own e shares of Distributing and jointly manage Business C.

Controlled1 and Controlled2 are proposed State A corporations. It is proposed that Shareholder A will own Distributing which will conduct Business A. Shareholder B

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will own Controlled1 which will conduct Business B. Finally, Shareholders C and D will own Controlled2 which will conduct Business C.

Financial information has been received that indicates that Distributing has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

In order to enable each of the businesses to be operated and managed independently by the shareholders who are primarily responsible for such business, Distributing proposes a corporate separation comprised of the transactions set forth below ("the Proposed Transactions").

- (i) Distributing will form Controlled1 and Controlled2.
- (ii) Distributing will transfer all of the assets and liabilities associated with Business B to Controlled1 and all of the assets and liabilities associated with Business C to Controlled2 in exchange for the common stock of each entity ("the Contributions").
- (iii) Distributing will distribute solely Controlled1's common stock to Shareholder B and solely Controlled2's common stock to Shareholders C and D in exchange for all of their shares of Distributing stock ("the Distributions").

REPRESENTATIONS

The taxpayer has made the following representations in connection with the Proposed Transactions:

- (a) The fair market value of Controlled1 and Controlled2 stock and other consideration received by each shareholder of Distributing will be approximately equal to the fair market value of Distributing stock surrendered by the shareholders in the Distributions.
- (b) 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 shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operation, and there have been no substantial operational changes to such business since the date of the last financial statements submitted.

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- (d) Following the transactions, Distributing, Controlled1, and Controlled2 will each continue, independently and with its separate employees, the active conduct of its business.
- (e) The Distribution of Controlled1 and Controlled2 Stock is carried out for the corporate business purpose of allowing each business to operate independently of the others and transferring ownership of each business to the shareholders responsible for its management. The Distribution of Controlled1 and Controlled2 Stock is motivated, in whole or substantial part, by this corporate business purpose.
- (f) Distributing is an S corporation (within the meaning of section 1361(a)). Controlled1 and Controlled2 will elect to be S corporations pursuant to section 1362(a) on the first available date after the Distributions and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing, Controlled1, or Controlled2.
- (g) There is no plan or intention by the Shareholders of Distributing, Controlled1, or Controlled2 to sell, exchange, or otherwise dispose of any of their stock in either Distributing, Controlled1, or Controlled2 after the Proposed Transactions.
- (h) There is no plan or intention by either Distributing, Controlled1, or Controlled2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Proposed Transactions, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.
- (i) There is no plan or intention to liquidate Distributing, Controlled1, or Controlled2, to merge any of these corporations with any other corporation, or to sell or otherwise dispose of the assets of any of these corporations after the Proposed Transactions, except in the ordinary course of business.
- (j) The Distribution of Controlled1 and Controlled2 stock will not be distributions within the meaning of section 355(d)(2) because immediately after the Distributions: (i) no person will hold disqualified stock in Distributing that will constitute a 50 percent or greater interest in Distributing, and (ii) no person will hold disqualified stock in Controlled1 and Controlled2 that will constitute a 50 percent or greater interest in Controlled1 or Controlled2, within the meaning of section 355(d).
- (k) The total adjusted bases and the fair market value of the assets to be transferred to Controlled1 and Controlled2 by Distributing each equals or

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exceeds the sum of the liabilities assumed by Controlled1 and Controlled2 respectively, plus any liabilities to which the transferred assets are subject. The liabilities assumed in the Proposed Transactions 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.

- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transactions.
- (m) No intercorporate debt will exist between Distributing, Controlled1, or Controlled2 at the time of, or subsequent to the Distributions.
- (n) Payments made in connection with all continuing transactions, if any, between Distributing, Controlled1, and Controlled2, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (o) No two parties to the Proposed Transactions are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (p) The Distributions are 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 entitled to vote of either Distributing, Controlled1, or Controlled2, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing, Controlled1, or Controlled2.

RULINGS

Based solely on the information submitted and on the representations set forth above, it is held as follows:

1. The Contributions followed by the Distributions will be reorganizations within the meaning of section 368(a)(1)(D). Distributing, Controlled1, and Controlled2 will each be a "party to a reorganization" under section 368(b).
2. No gain or loss will be recognized by Distributing on the Contributions (section 361(a) and section 357(a)).
3. No gain or loss will be recognized by Controlled1 or Controlled2 on the Contributions (section 1032(a)).

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4. The basis of each asset received by Controlled1 and Controlled2 in the Contributions will be the same as the basis of that asset in the hands of Distributing immediately prior to the Contributions (section 362(b)).
5. The holding period of each asset received by Controlled1 and Controlled2 in the Contributions will include the period during which Distributing held that asset (section 1223(2)).
6. No gain or loss will be recognized by Distributing on the Distributions (section 361(c)(1)).
7. No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholders on the Distributions (section 355(a)(1)).
8. The aggregate basis of Distributing, Controlled1, and Controlled2 stock in the hands of the shareholders of Distributing, immediately following the Distributions, will be the same as the aggregate basis of the Distributing stock held immediately before the Distributions, allocated in proportion to the fair market value of each in accordance with section 1.358-2(a)(2) (section 358(a)(1), (b) and (c)).
9. The holding periods of Controlled1 and Controlled2 stock received by each Distributing shareholder will include the holding period of Distributing stock with respect to which the Distributions are made, provided that such Distributing stock is held as a capital asset by the shareholders on the date of the Distributions (section 1223(1)).
10. Proper allocation of earnings and profits between Distributing, Controlled1, and Controlled2 will be made under section 1.312-10(a).
11. Proper allocations of the accumulated adjustments account between Distributing, Controlled1, and Controlled2 will be made in the same manner as the earnings and profits adjustments will be made under section 1.312-10(a).

No opinion is expressed about the tax treatment of the Proposed Transactions 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. Specifically, we express or imply no opinion concerning whether Distributing is a valid S corporation or whether Controlled1 or Controlled2 is otherwise eligible to be an S corporation.

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CAVEATS AND PROCEDURAL STATEMENTS

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Charles M. Levy
Reviewer, Branch 2
Office of Associate Chief Counsel
(Corporate)

cc: