

PLR-116447-03

Shareholder e =

Shareholder f =

Shareholder g =

Shareholder h =

Shareholder i =

Y =

Dear :

This letter responds to your letter dated March 6, 2003 in which you requested rulings under section 355 of the Internal Revenue Code. Additional information regarding your request has been submitted in letters dated June 18, 2003 and July 10, 2003. The material information submitted for consideration is summarized below.

Distributing, a State X corporation, is an S corporation that uses the cash method of accounting and a calendar year. Distributing is primarily engaged in Business A. Distributing has outstanding voting and nonvoting common stock, Y% of which is held by Shareholders a and b ("Group 1"), Y% is held by Shareholders c, d, and e ("Group 2"), and Y% is held by shareholders f, g, h, and i ("Group 3"). Distributing has no other securities outstanding.

Distributing has supplied financial information that indicates that Business A had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Controlled 1 and Controlled 2 will each be newly formed State X corporations, will each elect to be an S corporation, and will each use the cash method of accounting. Initially, all the outstanding stock in Controlled 1 and Controlled 2 will be held by Distributing.

The shareholders of Distributing have had continuing disputes and disagreements between each other with respect to the management and operation of Business A as conducted by Distributing. These disputes adversely affect the normal operations of the business. The shareholders have decided to engage in a split-off so that the Group 1 and Group 2 shareholders may go their separate ways.

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Accordingly, the parties intend to complete the following steps (“Steps”) in the proposed transaction:

(I) Distributing will form Controlled 1 and Controlled 2, each of which will have outstanding voting and nonvoting common stock.

(II) Distributing will transfer to each of Controlled 1 and Controlled 2 approximately one-third of its assets (and related liabilities) in exchange for Controlled 1 and Controlled 2 stock. Distributing will retain approximately one-third of its assets.

(III) Distributing will distribute all the Controlled 1 stock to Group 1 in exchange for all their stock in Distributing.

(IV) Distributing will distribute all the Controlled 2 stock to Group 2 in exchange for all their stock in Distributing.

(V) Group 3 will retain its stock in Distributing.

The following representations have been made in connection with proposed Steps (I) through (V), involving the distribution of stock in Controlled 1 and Controlled 2:

(a) The fair market value of the Controlled 1 and Controlled 2 stock to be received by each of the Group 1 and Group 2 shareholders, respectively, will be approximately equal to the fair market value of the Distributing stock surrendered by such shareholder in the exchange.

(b) No part of the consideration distributed by Distributing is being received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.

(c) The 5 years of financial information submitted on behalf of Distributing 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.

(d) Following the transaction, each of Distributing, Controlled 1, and Controlled 2 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.

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(e) The distributions of the stock of Controlled 1 and Controlled 2 will be carried out to resolve shareholder disputes. The distribution of the stock of Controlled 1 and Controlled 2 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)). Controlled 1 and Controlled 2 will elect to be S corporations pursuant to section 1362(a) on the earliest possible date after the distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of Distributing, Controlled 1, or Controlled 2.

(g) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in Distributing, Controlled 1, or Controlled 2 after the transaction.

(h) There is no plan or intention by any of Distributing, Controlled 1, or Controlled 2 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 Rev. Proc. 96-30.

(i) There is no plan or intention to liquidate Distributing, Controlled 1, or Controlled 2, to merge Distributing, Controlled 1, or Controlled 2 with any other corporation, or to sell or otherwise dispose of the assets of Distributing, Controlled 1, or Controlled 2 after the transaction except in the ordinary course of business.

(j) In each case, the total adjusted basis and the fair market value of the assets transferred to Controlled 1 and Controlled 2 by Distributing equals or exceeds the sum of liabilities (as determined under section 357(d)) assumed by Controlled 1 and Controlled 2 plus any liabilities to which the transferred assets are subject.

(k) The liabilities assumed in this transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and associated with the assets being transferred.

(l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of this transaction.

(m) No intercorporate debt will exist between any of Distributing, Controlled 1, and Controlled 2 at the time of, or subsequent to, the distribution of Controlled 1 and Controlled 2 stock.

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(n) Payments made in connection with all continuing transactions, if any, between any of Distributing, Controlled 1, and Controlled 2 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 transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

(p) No Distributing shareholder or shareholders will hold immediately after the distribution disqualified stock within the meaning of section 355(d)(3) which constitutes a 50% or greater interest in Distributing, Controlled 1, or Controlled 2.

(q) 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% or more of the total combined voting power of all classes of stock of either Distributing, Controlled 1, or Controlled 2, or stock possessing 50% or more of the total value of all classes of stock of either Distributing, Controlled 1, or Controlled 2.

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

(1) The transfer of assets by Distributing to Controlled 1 and Controlled 2 in exchange for all the stock in Controlled 1 and Controlled 2 and the assumption by Controlled 1 and Controlled 2 of liabilities associated with the assets transferred, followed by the distribution of all the Controlled 1 stock to Group 1 and the distribution of all the Controlled 2 stock to Group 2 constitutes a reorganization within the meaning of section 368(a)(1)(D) of the Code.

(2) Distributing will recognize no gain or loss on the transfer of its assets, subject to liabilities, to Controlled 1 and Controlled 2 in exchange for Controlled 1 and Controlled 2 common stock and the assumption by Controlled of the liabilities associated with the transferred assets. Sections 361(a) and 357(a).

(3) Controlled 1 and Controlled 2 will recognize no gain or loss on the receipt of Distributing's assets, subject to liabilities, in exchange for the Controlled 1 and Controlled 2 common stock. Section 1032(a).

(4) The basis of each asset received by Controlled 1 and Controlled 2 from Distributing will be equal to the basis of such asset in the hands of Distributing immediately prior to the transaction. Section 362(b).

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(5) The holding period of each asset received by Controlled 1 and Controlled 2 from Distributing will include the period during which such asset was held by Distributing. Section 1223(2).

(6) No gain or loss will be recognized by Distributing on the distribution of the Controlled 1 and Controlled 2 stock to Group 1 and Group 2. Section 361(c).

(7) No gain or loss will be recognized by (and no income will be included in the income of) the Group 1 or Group 2 shareholders upon the receipt of the Controlled 1 and Controlled 2 stock in cancellation of their Distributing stock. Section 355(a)(1).

(8) The aggregate basis of Controlled 1, Controlled 2, and Distributing stock in the hands of Group 1, Group 2, and Group 3 immediately after the distribution will be the same as the basis of the Distributing stock in the hands of Group 1, Group 2, and Group 3 immediately prior to the distribution. Section 358(a)(1); Treas. Reg. § 1.358-1(a).

(9) As provided in section 312(h), proper allocation of earnings and profits among Distributing, Controlled 1, and Controlled 2 will be made under Treas. Reg. § 1.312-10(a).

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 transaction that are not directly covered by the above rulings.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code 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 transaction covered by this ruling letter is consummated.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of the factual information, representations, and other data may be required as part of the audit process.

Pursuant to the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer and a second authorized representative.

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Sincerely yours,

Lisa A. Fuller
Assistant Branch Chief, Branch 1
Office of Associate Chief Counsel
(Corporate)

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cc