

**Internal Revenue Service**

Department of the Treasury  
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Person To Contact:

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Telephone Number:

Refer Reply To:

CC:CORP:B02 – PLR-147844-03

Date:

February 09, 2004

Legend:

Distributing =

Controlled =

Shareholder =

Key Employee 1 =

Key Employee 2 =

Business A =

State X =

Dear

This is in response to your letter dated July 31, 2003, in which you requested rulings as to the federal income tax consequences of a proposed transaction. Additional information was received in letters dated November 25 and December 11, 2003, and January 13, 2004. The information submitted for consideration is summarized below.

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Distributing is a State X corporation engaged in Business A. Distributing has elected to be taxed as an S corporation for federal tax purposes. Controlled is a wholly owned subsidiary of Distributing, which Distributing has elected to treat as its Qualified Subchapter S Subsidiary (QSub).

Distributing and Controlled each employ a manager whose continued affiliation is critical to success of the business. Each manager desires to obtain an equity interest in the business with which he is currently involved without investing in the business of the other facility. It is believed that retention of the managers is critical to the continued success and profitability of the businesses and that unless the managers are given the opportunity to become partial owners they will leave the businesses for other opportunities. The key employees have further indicated that each is only interested in acquiring equity in the specific business for which each key employee works. Controlled's Key Employee does not wish to own stock in Controlled as long as it remains a subsidiary of Distributing, due to issues involving the allocation of management resources, distribution of dividends and the corporation's ability to remain an S corporation. Controlled's Key Employee desires an equity interest in Distributing alone, based on concerns over performance and profitability of Controlled.

In order to accomplish the above, the taxpayer proposes the following transaction:

Distributing will distribute all of the stock of controlled to Shareholder in exchange for an amount of Distributing stock equal in value to the Controlled stock received in exchange therefor (the "Distribution").

In connection with the Distribution the taxpayer has made the following representations:

- (a) The fair market value of Controlled stock and other consideration to be received by Shareholder in the Distribution will be approximately equal to the fair market value of Distributing stock surrendered by Shareholder in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by Shareholder as a creditor, employee, or in any other 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 with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

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(d) The five years of financial information submitted on behalf of Controlled is representative of Controlled'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) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to provide each key employee with an equity interest in the business with which he is currently involved. The distribution of the stock is motivated in whole or substantial part by this corporate business purpose.

(f) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the transaction except for transfers by gift to family members of Shareholder or transfers to charitable organizations. In addition, shares of Distributing and Controlled will be transferred to certain key employees of Distributing and Controlled.

(g) 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 § 4.05(1)(b) of Rev. Proc. 96-30.

(h) There is no plan or intention by either Distributing or Controlled to make any other disposition of any of their stock in, or securities of, either Distributing or Controlled after the transaction, other than to provide certain key employees with equity interests in the applicable businesses.

(i) 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.

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

(k) 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 parties bargaining at arm's length.

(l) The Distribution 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 combined voting power of all

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classes of stock entitled to vote of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

(m) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated business activities conducted by Distributing prior to the transaction.

(n) For purposes of section 355(d), immediately after the Distribution no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of each distribution.

(o) For purposes of section 355(d), immediately after the Distributions no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of stock of Controlled entitled to vote, or 50 percent or more of the total value of shares of all classes of stock of said corporations, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the distribution.

(p) Distributing is an S corporation (within the meaning of § 1361(a)). Controlled will elect to be an S corporation pursuant to § 1362(a) on the first available date after the distribution.

(q) Key Employee 1 and 2 will each receive a distribution of 5% of the outstanding shares of the corporation for which the employee works by October 2004, so long as the employee remains employed by his corporation on the distribution date.

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

(1) No gain or loss will be recognized by Distributing upon the Distribution. Section 355(c)(1).

(2) No gain or loss will be recognized by, and no amount will be included in the income

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of, Shareholder upon the receipt of the Controlled stock. Section 355(a)(1).

(3) The basis of the Controlled stock to be received by Shareholder will be the same as the basis of the Distributing stock surrendered in exchange therefor. Section 358(a)(1).

(4) The holding period of the Controlled stock received by 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 exchange. Section 1223(1).

(5) Proper allocation of earnings and profits between Distributing and Controlled will be made under §§ 312(h), 1.312-10(b).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

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.

Sincerely,

*Gerald B. Fleming*

Gerald B. Fleming  
Senior Technician Reviewer  
Office of Associate Chief Counsel  
(Corporate)