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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:CORP:B06
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Date:
December 22, 2008

LEGEND

Distributing =

Controlled =

Business 1 =

Business 2 =

Date 1 =

Date 2 =

Shareholder A =

Shareholder B =

#a =

State X =

Dear :

This letter responds to your August 1, 2008, letter requesting rulings on certain federal income tax consequences of the Proposed Transaction (described below). The information provided in that letter and in later correspondence 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. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Moreover, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Distribution (described below): satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) of the Internal Revenue Code (the "Code") and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation or both (see section 355(e)(2)(a)(ii) and Treas. Reg. § 1.355-7).

FACTS

Distributing is currently an S corporation formed in State X on Date 1. Distributing has been treated as an S corporation since Date 2. Distributing has a single class of voting common stock. Shareholder A and Shareholder B are the only shareholders of Distributing. Shareholder A and Shareholder B each own #a shares of Distributing voting common stock.

For at least the last five years Distributing has operated Business 1 and Business 2 in State X.

Financial information has been received indicating that Business 1 and Business 2 had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Proposed Transaction

Distributing has proposed the following transactions (collectively, the "Proposed Transaction").

- (i) Distributing will form Controlled in State A. Controlled will use the accrual method of accounting.
- (ii) Distributing will transfer Business 2 along with related liabilities to Controlled in exchange for all of the Controlled common stock. (The Contribution).
- (iii) Distributing will distribute (pro rata) all of the Controlled common stock to Shareholder 1 and Shareholder 2. (The Distribution).

- (iv) Distributing and Controlled each will continue to engage in Business 1 and Business 2 respectively. Distributing and Controlled will share certain employees.
- (v) Controlled will make an S corporation election.
- (vi) Steps (i)-(iii) and (v) will all occur at the same time.

The following representations are made with respect to the Distribution

REPRESENTATIONS

- a) No part of the consideration to be distributed by the Distributing corporation will be received by a shareholder as a creditor, employee or in any capacity other than that of a shareholder of the corporation.
- b) The 5 years of financial information submitted on behalf of the Distributing corporation is representative of the corporation's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- c) The 5 years of financial information submitted on behalf of the business contributed to the Controlled corporation is representative of the business's present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- d) Except for certain employees that Distributing and Controlled will share, following the transaction, the Distributing and Controlled corporation will each continue the active conduct of its business, independently and with its separate employees.
- e) The distribution of the stock of the Controlled corporation is carried out for the following corporate business purposes: (i) Enhancement of the bonding and business opportunities for Business 1, (ii) Removal of impediments to the financing opportunities of Business 2, (iii) Efficient management and execution of the activities of both Distributing and Controlled and (iv) Long term planning for the efficient management of the businesses of Distributing and Controlled over lower generational ownership. The distribution of the stock of the Controlled corporation is motivated, in whole or substantial part, by one or more of these corporate business purposes.

- f) The transaction is not used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both. See § 355(a)(1)(B).
- g) The total adjusted basis and the fair market value of the assets transferred to Controlled in the Contribution will equal or exceed the sum of (i) the total liabilities assumed (within the meaning of § 357(d)) by Controlled, and (ii) the total amount of any money and the fair market value of any other property (within the meaning of § 361(b)) received by Distributing and transferred to its creditors in connection with the reorganization.
- h) The liabilities assumed (within the meaning of § 357(d)) by Controlled in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- i) The total fair market value of the assets transferred to Controlled in the Contribution will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing in connection with the exchange.
- j) The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
- k) The aggregate fair market value of the assets transferred to Controlled in the Contribution will equal or exceed the aggregate adjusted basis of these assets.
- l) The distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- m) No intercorporate debt will exist between the distributing corporation and the controlled corporation at the time of, or subsequent to, the distribution of the controlled corporation stock.
- n) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 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 § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

- o) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- p) Payments made in connection with all continuing transactions, if any, between the distributing and controlled corporation, will be for fair market value based on terms and conditions arrived at by the parties at arm's length.
- q) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- r) The distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- s) Immediately after the Distribution, neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).
- t) Distributing is an S corporation (within the meaning of § 1361(a)). Immediately following the Proposed Transaction, Controlled will elect to be an S corporation pursuant to § 1362(a). There is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

RULINGS

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

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

to Controlled in exchange for Controlled stock and the assumption by Controlled of liabilities of Distributing in the Contribution. Sections 361(a) and 357(a).

- (3) Controlled will recognize no gain or loss on the receipt of Distributing's assets subject to liabilities, in exchange for the common stock of Controlled. Section 1032(a)
- (4) The basis of each asset received by Controlled from Distributing will be equal to the basis of such asset in the hands of Distributing immediately prior to its transfer. Section 362(b).
- (5) The holding period for each asset received by Controlled from Distributing will include the period during which Distributing held the asset. Section 1223(2).
- (6) No gain or loss will be recognized by Distributing on the distribution of the stock of Controlled to Shareholder A and Shareholder B. Section 361(c).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Shareholder A and Shareholder B upon their receipt of Controlled stock from Distributing. Section 355(a)(1).
- (8) The aggregate basis of Controlled and Distributing stock in the hands of Shareholder A and Shareholder B immediately after the distribution will be the same as the basis of the Distributing stock in the hands of Shareholder A and Shareholder B immediately prior to the distribution allocated between Distributing stock and Controlled stock in proportion to the relative fair market value of each. Section 358(a)(1)(b) and (c); Treas. Reg. § 1.358-1(a), 1.358-2(a)(2).
- (9) The holding period of Controlled stock received by Shareholder A and Shareholder B will include the holding period of the Distributing stock with respect to which the distribution was made, provided the Distributing stock is a capital asset on the date of distribution. Section 1223(1).
- (10) Proper allocation of Distributing's earnings and profits will be made under §§ 312(h) and 1.312-10(a).
- (11) Distributing's accumulated adjustments account immediately before the transaction will be allocated among Distributing and Controlled in a manner similar to the manner in which Distributing's earnings and profits will be allocated under §§ 312(h) (see §§ 1.312-10(a) and 1.1368-2(d)(3)).
- (12) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an

ineligible shareholder for any portion of its first taxable year under §1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under §1361, Controlled will be eligible to elect to be a subchapter S corporation under §1362(a) for its first taxable year.

- (13) Controlled will be subject to § 1374 with respect to any asset transferred to Controlled to the same extent Distributing was subject to § 1374 with respect to such asset. For purposes of § 1374, the recognition period for Controlled will be reduced by the portion of Distributing's recognition period that expired prior to the transfer of these assets to Controlled (§ 1374(d)(8) and Ann. 86-128, 1986-51 I.R.B. 22).

CAVEATS

We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations or the tax treatment of any condition existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) Whether the Distribution satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) Whether the Distribution is being used principally as a device for the distribution of earnings and profits of Distributing or Controlled. (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); and (iii) Whether the Distribution is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or Controlled (see section 355(e) and Treas. Reg. § 1.355-7).

PROCEDURAL STATEMENT

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 must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this letter ruling.

Sincerely,

Richard Heinecke
Assistant to the Branch Chief, Branch 6
Office of Associate Chief Counsel (Corporate)

cc: