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Department of the Treasury

Washington, DC 20224

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Refer Reply To:
CC:PSI:1-PLR-130592-00
Date:
May 9, 2001

Legend:

X =

Subsidiary 1 =

Subsidiary 2 =

Subsidiary 3 =

Subsidiary 4 =

State =

This responds to a letter dated December 4, 2000, together with subsequent correspondence, submitted on behalf of X, requesting rulings on certain federal income tax consequences of the restructuring described below.

FACTS

X is a subchapter C corporation formed under State law. X is the common parent of four wholly-owned subsidiaries, Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4. X and Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 own a variety of publications, use an overall accrual method of accounting, and have elected to treat prepaid subscription income under the provisions of section 455 of the Internal Revenue Code.

X proposes to restructure its business operations according to subject matter. In order to accomplish this objective, Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will each merge with and into X pursuant to the laws of State. X will then form various limited liability companies ("LLCs") which will be entities disregarded as separate from their owner for federal tax purposes under section 307.7701-3 of the Procedure and Administration Regulations. X will transfer the assets and liabilities relating to publications with related subject matters into the corresponding LLCs.

Representations

The following representations have been made in connection with the restructuring:

(a) X, on the date of the adoption of the plan of liquidation and at all times until the final liquidating distribution is completed will be the owner of at least 80% of the single outstanding class of each of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4.

(b) No shares of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will have been redeemed preceding the adoption of the plan of complete liquidation of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4.

(c) All distributions from Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 pursuant to the plan of complete liquidation will be made within a single taxable year of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4.

(d) As soon as the first liquidating distribution has been made, each of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will cease to be a going concern and each of their activities will be limited to winding up affairs, paying their debts, and distributing their assets to X.

(e) Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will retain no assets following the final liquidating distribution.

(f) Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will not have acquired assets in a nontaxable transaction at any time except for acquisitions occurring more than three years prior to the date of adoption of the plan of liquidation.

(g) No assets of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 have been or will be disposed of by any of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4, or X except for dispositions in the ordinary course of business and dispositions occurring more than three years prior to the adoption of the plan of liquidation.

(h) The liquidation of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will not be preceded or followed by a reincorporation in, or transfer or sale to, a recipient corporation.

(i) Prior to the adoption of the liquidation plan, no assets of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will have been distributed in kind, transferred, or sold to X except for (i) transactions in the normal course of business and (ii) transactions occurring more than three years prior to adoption of the liquidation plan.

(j) Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will report all earned income represented by assets that will be distributed to X such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.

(k) The fair market value of the assets of Subsidiary 1 will exceed the fair market value of its liabilities both at the date of adoption of the plan of complete liquidation and immediately prior to the time the first liquidating distribution is made.

(l) The fair market value of the assets of Subsidiary 2 will exceed the fair market value of its liabilities both at the date of adoption of the plan of complete liquidation and immediately prior to the time the first liquidating distribution is made.

(m) The fair market value of the assets of Subsidiary 3 will exceed the fair market value of its liabilities both at the date of adoption of the plan of complete liquidation and immediately prior to the time the first liquidating distribution is made.

(n) The fair market value of the assets of Subsidiary 4 will exceed the fair market value of its liabilities both at the date of adoption of the plan of complete liquidation and immediately prior to the time the first liquidating distribution is made.

(o) X is not an organization that is exempt from federal income tax under section 501 or any other provision of the Code.

LAW AND ANALYSIS

Rulings 1 through 5

X has requested rulings that the mergers of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 with and into X pursuant to the laws of State will qualify as a complete liquidation of each subsidiary under section 332(a) of the Code.

The rulings are as follows:

(1) The receipt by X of the assets and liabilities of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will each qualify as a complete liquidation of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4. Section 332(a).

(2) No income, gain or loss will be recognized by any of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 as a result of transferring their assets and liabilities to X. Section 337(a).

(3) The basis of each asset received by X from each of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will be equal to the basis of that asset in the hands

of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 respectively, immediately before the transaction. Section 334(b)(1).

(4) The holding period of each asset received by X from each of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will include the period during which that asset was held by each of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 prior to their complete liquidation. Section 1223(2).

(5) Pursuant to section 381(a) and section 1.381(a)-1 of the Income Tax Regulations, X will succeed to and take into account the items of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 described in section 381(c), including the earnings and profits, or deficit in earnings and profits, of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 as of the date of the transfer. Any deficit in the earnings and profits of X or Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 will be used only to offset the earnings and profits accumulated after the date of the transfer. These items will be taken into account by X subject to the conditions and limitations specified in sections 381, 382, 383, and 382, and the regulations thereunder.

Ruling 6

X has requested a ruling that the mergers of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 into X will not result in the immediate inclusion in gross income of any prepaid subscription income existing on the date of each merger.

Effective for tax years beginning after 1957, section 455 permits taxpayers to elect to include "prepaid subscription income," as defined in section 455(d)(1) and section 1.455-5(a) in gross income for the tax years during which a liability to furnish or deliver a newspaper, magazine, or other periodical exists, rather than for the year in which the income is received. See section 1.455-1.

Section 455(d)(2) provides that the term "liability" means a liability "to furnish or deliver a newspaper, magazine, or other periodical." See section 1.455-5(b).

Section 455(b) describes two situations that require deferred subscription income to be immediately included in gross income. Section 455(b)(1) provides that if the liability described in section 455(d)(2) ends, then so much of the prepaid subscription income as was not includible in gross income for preceding tax years must be included in gross income for the tax year in which the liability ends. Section 455(b)(2) provides a similar result "[i]f the taxpayer dies or ceases to exist."

Section 1.455-4 expounds on the two situations described in section 455(b). This section refers to the provisions of section 381 and the regulations issued thereunder for the treatment of prepaid subscription income in a transaction to which section 381(a) applies.

Section 381 discusses the carryover of specified items in certain corporate acquisitions.

Section 1.381(c)(4)-1 prescribes rules for determining the method of accounting to be used by an acquiring corporation after a section 381(a) transaction. When the acquiring corporation and the acquired corporation used the same method of accounting immediately prior to the section 381(a) transaction, section 1.381(c)(4)-1(b)(1) requires the acquiring corporation to continue using that method, unless it obtains the Commissioner's permission to change to another method. Example 3 of this section illustrates how the overall and deferral accounting method of section 455 continue when these methods were used by the acquiring and acquired corporation prior to the section 381(a) transaction.

In question is whether the planned mergers fall within the literal application of the acceleration provision of section 455(b). Here, four subsidiaries are merging into their common parent in transactions described in section 381(a). In regulations under section 381, the Service has provided explicit instructions for the mandatory carryover of a section 455 election in situations where the acquiring and acquired corporations have previously elected to defer income under section 455.

We conclude that the mergers of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 into X will not result in the immediate inclusion in gross income of any prepaid subscription income existing on the date of each merger. Section 1.381(c)(4)-1(b)(1) requires the taxpayer to continue using the income deferral method of section 455 and the taxpayer must carry over the closing balances of the prepaid subscription accounts of Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4.

Ruling 7

X has requested a ruling that X's prepaid subscription income account will not be immediately included in its gross income when X's assets and liabilities are transferred to the LLCs, and no income, gain, or loss otherwise will be realized by X or LLCs as a result of the transfer of property from X to LLCs.

Section 301.7701-3(b)(1)(ii) provides that a domestic eligible entity (a business organization not classified as a corporation under section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) with a single owner is disregarded as an entity separate from its owner for federal tax purposes unless the entity elects to be treated as a corporation. If the entity is disregarded, and its owner is a corporation, its activities are treated in the same manner as those of a division of its owner. 301.7701-2(a). In effect, X is treated as owning all of the assets and having all the liabilities of the LLCs.

We conclude that no income, gain, or loss will be realized by X or LLCs as a result of the transfer of property from X to LLCs. In particular, the transfer of X's assets and liabilities to the LLCs will not result in the immediate inclusion in gross income of any prepaid subscription income.

X is required by section 455(b) to include its deferred subscription income in its gross income only if (1) X's liability to furnish or deliver its publications ends or (2) X dies or ceases to exist. Here, X does not die or cease to exist with the transfers to the LLCs. Thus, the sole reason for ending the deferral of the prepaid subscription income that exists at the time the LLCs are formed is if X's liability ends with the transfers to the LLCs.

We conclude that because the LLCs are disregarded as entities separate from X, X's liability under section 455 will not end when it transfers the assets and liabilities to its LLCs. X must continue to use the income deferral method of section 455 and the closing balances of X's prepaid subscription income account are not accelerated into gross income when the assets and liabilities are transferred to the LLCs.

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. In particular, we express no opinion that X and its four subsidiaries properly elected under section 455 to defer prepaid subscription income.

This ruling is directed only to the taxpayer(s) requesting 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, a copy of this letter is being sent to your authorized representative.

Sincerely,
/s/Matthew Lay
Assistant to the Branch Chief, Branch 1
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
copy of this letter
copy for § 6110 purposes