

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:4-PLR-133116-02

Date:

October 17, 2002

LEGEND

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Z =

Business A =

Business B =

State A =

Date A =

Date B =

Date C =

Date D =

Year 1 =

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Year 2 =

a =b =

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, Date C, and Date D. The pertinent information submitted is summarized below.

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 of common stock which are held equally by b related shareholders.

Distributing is engaged in Businesses A and B. Each business has been conducted for more than five years. Shareholder A has been primarily responsible for the conduct of daily business operations. The shareholders disagree on business management, operation, and development.

Distributing will enter into an equipment lease and employment contract with Z upon certain terms and conditions substantially as revised under a letter of Date B (the "Lease and Employment Agreement").

Controlled will be a State A corporation and will be formed for the purpose of independently operating Business B. Controlled will elect S status on the first available date following the proposed transaction.

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 accommodate divergent shareholder interests and to eliminate shareholder disputes regarding the management, operation, and development of Distributing's businesses, Distributing proposes a corporate separation as set forth below (the "Proposed Transactions").

- (i) Distributing will form Controlled.

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- (ii) Distributing will transfer all the assets and liabilities associated with Business B to Controlled in exchange for the common stock of Controlled ("the Contribution").
- (iii) Distributing will distribute all of the Controlled common stock to Shareholder A solely in exchange for all of the shares of Distributing common stock held by Shareholder A ("the Distribution").

REPRESENTATIONS

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

- (a) The fair market value of Controlled stock received by Shareholder A of Distributing will approximately equal the fair market value of Distributing stock surrendered in the Distribution.
- (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.
- (d) Following the Proposed Transactions, Distributing and Controlled will continue the active conduct of its respective business, independently and with its separate employees.
- (e) The Distribution of Controlled is carried out for the corporate business purpose of resolving shareholder disputes. The Distribution of Controlled 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)). Controlled will elect to be an S corporation pursuant to section 1362(a) on the first available date after the Distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.
- (g) There is no plan or intention by the shareholders of Distributing or Controlled, to sell, exchange, transfer by gift, or otherwise dispose of any

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of their stock in either Distributing or Controlled after the Proposed Transactions.

- (h) 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 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 or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Proposed Transactions, except in the ordinary course of business.
- (j) The Distribution of Controlled stock will not be a distribution within the meaning of section 355(d)(2) because immediately after the Distribution: (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 Controlled that will constitute a 50 percent or greater interest in Controlled, within the meaning of section 355(d).
- (k) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled, 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 and Controlled at the time of, or subsequent to, the Distribution.
- (n) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (o) None of the parties to the Proposed Transactions are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (p) 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

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

RULINGS

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

1. The Contribution followed by the Distribution will be a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be a “party to a reorganization” under section 368(b).
2. No gain or loss will be recognized by Distributing on the Contribution (section 361(a) and section 357(a)).
3. No gain or loss will be recognized by Controlled on the Contribution (section 1032(a)).
4. The basis of each asset received by Controlled in the Contribution will be the same as the basis of that asset in the hands of Distributing immediately prior to the Contribution (section 362(b)).
5. The holding period of each asset received by Controlled in the Contribution 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 Distribution (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 Distribution (section 355(a)(1)).
8. The aggregate basis of Distributing and Controlled stock in the hands of the shareholders immediately following the Distribution will be the same as the aggregate basis of the Distributing stock held immediately before the Distribution, 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 period of Controlled stock received by the Distributing shareholder will include the holding period of Distributing stock with

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respect to which the Distribution is made, provided that such Distributing stock is held as a capital asset by the shareholder on the date of the Distribution (section 1223(1)).

10. Proper allocation of earnings and profits between Distributing and Controlled will be made under section 1.312-10(a).
11. Distributing's momentary ownership of stock of Controlled as part of the Proposed Transactions will not cause Controlled to be an ineligible corporation under section 1361(b)(1)(B). Therefore, assuming Controlled will otherwise meet the requirements of a small business corporation under section 1361, Controlled will be eligible to make an S corporation election under section 1362(a) for its first taxable year.
12. Distributing's accumulated adjustments account immediately before the transaction will be allocated between Distributing and Controlled in a manner similar to which Distributing's earnings and profits will be allocated under section 312(h) (section 1.1368-2(d)(3)).
13. Controlled will be subject to section 1374 with respect to any asset transferred to Controlled to the same extent Distributing was subject to section 1374 with respect to such asset. For purposes of section 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. Section 1374(d)(8) and Ann. 86-128, 1986-51 I.R.B. 22.

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.

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.

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.

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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)