

Internal Revenue Service

Department of the Treasury

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Date:
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LEGEND

- Distributing =

- Controlled =

- Business A =

- Business B =

- State A =

- Bank A =

- Bank B =

- Date A =

- Date B =

- Date C =

- Date D =

- a =

- b =

- c =

- d =

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

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was received in letters of Date B, Date C and Date D. The pertinent information submitted 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. 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.

SUMMARY OF FACTS

Distributing is a State A S corporation. Distributing has issued and outstanding a shares of stock which are held by d shareholders.

Controlled is a State A corporation engaged in Business B and has b issued and outstanding shares of common stock all held by Distributing. Business B is conducted by Controlled through a limited liability company that Controlled owns all of the interest in except for a c percent profits interest held by employees.

Financial information has been received which indicates that Distributing through its subsidiaries and Controlled have 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 enable Controlled to obtain release from joint and several liability as guarantor of the Bank A Credit Facility and establish its own separate credit facility with Bank B, Distributing proposes a corporate separation comprised of the transaction set forth below (the "Proposed Transaction").

- (i) Distributing's deemed transfer of Controlled's assets and liabilities to Controlled in exchange for all of Controlled's Common Stock (the "Contribution").
- (ii) Pro rata distribution of solely Controlled's Common Stock to shareholders of Distributing (the "Distribution").

REPRESENTATIONS

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

- (a) 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.
- (b) The five years of financial information submitted on behalf of Distributing's Business A represents its present operation, and there have been no

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substantial operational changes since the date of the last financial statements submitted.

- (c) The five years of financial information submitted on behalf of Distributing's Business B, is representative of Distributing's Business B'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 transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its business.
- (e) The Distribution of the Controlled Stock is carried out for the corporate business purposes of (i) eliminating joint and several liability of Controlled as guarantor of the Bank A Credit Facility and to enable Controlled to obtain a separate credit facility and (ii) to better protect Business B from the potential liabilities of Business A. The Distribution of the Controlled Stock is motivated, in whole or substantial part, by the forgoing corporate business purposes.
- (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 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 Proposed Transaction.
- (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 transaction, 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) Distributing and Controlled have no accumulated earnings and profits at the beginning of their respective taxable years. Distributing and Controlled will have no current earnings and profits as of the date of the Distribution. No distribution of property by Distributing immediately before the transaction would require recognition of gain resulting in current earnings and profits for the taxable year of the Distribution. Distributing is not aware of, nor is Distributing planning or intending, any event that will result in Distributing or Controlled having positive current or accumulated earnings and profits after the Distribution.

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- (j) 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.
- (k) The Distribution of Controlled stock will not be a disqualified 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).
- (l) The total adjusted basis and the fair market value of the assets 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 transaction 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.
- (m) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the Proposed Transaction.
- (n) No corporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (o) 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.
- (p) No two parties to the transaction are investment companies as defined in sections 368(a)(2)(F)(iii) and (iv).
- (q) The Distribution is not part of a plan or a 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 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

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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. Upon the Contribution, Controlled will be treated under section 1361(b)(3)(C) as a new corporation acquiring all of its assets and assuming all of its liabilities from Distributing immediately before the termination of Controlled’s qualified subchapter S subsidiary election in exchange for the Controlled Stock.
3. No gain or loss will be recognized by Distributing on the Contribution (section 361(a) and section 357(a)).
4. No gain or loss will be recognized by Controlled on the Contribution (section 1032(a)).
5. 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)).
6. 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)).
7. No gain or loss will be recognized by Distributing on the Distribution (section 361(c)(1)).
8. 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)).
9. Distributing’s momentary ownership of the Controlled Stock as part of the reorganization under section 368(a)(1)(D) will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). If Controlled otherwise meets 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.
10. The aggregate basis of the Controlled stock and the Distributing stock in the hands of the shareholders of Distributing, immediately following the Distribution, will be the same as the basis of the Distributing stock held immediately before the Distribution, allocated in proportion to the fair

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market value of each in accordance with section 1.358-2(a)(2) (section 358(a)(1), (b) and (c)).

11. The holding period of the Controlled stock received by each Distributing shareholder will include the holding period of the Distributing stock on which the Distribution is made, provided the Distributing stock is held as a capital asset on the date of the Distribution (section 1223(1)).

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 specifically covered by the above rulings. Specifically, we express or imply no opinion concerning whether Distributing is a valid S corporation or whether Controlled is otherwise eligible to be an S corporation.

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.

A copy of this letter must be attached to any income tax return to which it is relevant.

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,
Charles M. Levy
Reviewer, Branch 2
Office of Associate Chief Counsel (Corporate)