



distributing or controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 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 or controlled corporation. (§ 355(e)(2)(A)(ii) and § 1.355-7T).

### **Summary of Facts**

Distributing is an S corporation which is wholly owned by Shareholder. Distributing is engaged in Business A and Business B. Financial information submitted by Distributing indicates that Business A and Business B have each had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

### **Proposed Transaction**

For what is represented to be a valid business purpose, Distributing has proposed the following transaction to separate its Business A from Business B (the "Proposed Transaction"):

- (i) Distributing will change its name to X and form Controlled.
- (ii) Distributing will transfer all of the assets of Business B to Controlled in exchange for all of Controlled's stock and Controlled's assumption of liabilities (the "Contribution").
- (iii) Distributing will distribute all the stock of Controlled to Shareholder (the "Distribution"). Controlled will elect to be an S corporation pursuant to § 1362(a) on the first available date after the Distribution.

### **Representations**

The taxpayer has made the following representations regarding the Contribution and Distribution:

- (a) No part of the consideration distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a Distributing shareholder.
- (b) The five years of financial information submitted on behalf of Distributing's Business A and Business B represents the present operations of each business, and regarding each business, there have been no substantial operational changes since the date of the last financial statements submitted.

- (c) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (d) The Distribution is being carried out for the following business purpose: to significantly enhance the protection of the Business A assets. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (e) The Distribution is not used principally as a device for the distribution of the earnings or profits of Distributing, Controlled, or both.
- (f) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing in the Contribution will each equal or exceed the sum of the liabilities assumed (as determined under § 357(d)).
- (g) The liabilities assumed (as determined under § 357(d)) by Controlled in the Contribution will have been incurred in the ordinary course of business and will be associated with the assets transferred.
- (h) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.
- (i) No two parties to the Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (j) 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.
- (k) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7T) 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).
- (l) 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.

- (m) 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 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.
- (n) The total fair market value of the assets of Distributing transferred to Controlled will equal or exceed the aggregate adjusted basis of the transferred assets.

### **Rulings**

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

- (1) The Contribution, followed by the Distribution will qualify as a reorganization under § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" under § 368(b).
- (2) Distributing will recognize no gain or loss on the Contribution (§ 357(a) and § 361(a)).
- (3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).
- (4) The basis that Controlled has in each asset received from Distributing in the Contribution will equal the basis of that asset in the hands of Distributing immediately before its transfer (§ 362(b)).
- (5) The holding period of each asset received by Controlled in the Contribution will include the period Distributing held that asset (§ 1223(2)).
- (6) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder upon the receipt of Controlled stock (§ 355(a)(1)).
- (8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of Shareholder immediately after the Distribution will equal Shareholder's

aggregate basis in the Distributing stock held immediately before the Distribution. Such aggregate basis will be allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(b) and (c)).

(9) The holding period of the Controlled stock received by Shareholder will include the holding period of the Distributing stock on which the Distribution is made, provided such stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(10) A proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 312(h) and § 1.312-10(a).

(11) Distributing's momentary ownership of the stock of Controlled as part of the Proposed Transaction 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 be a sub chapter S corporation under § 1362(a) for its first taxable year.

### **Caveats**

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations or 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. In particular, no opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Distribution is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see § 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii); and (iv) whether Distributing is a valid S corporation and as to whether Controlled is otherwise eligible to be an S corporation.

### **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.

Each taxpayer involved in the Proposed Transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the Proposed Transaction is completed.

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,

*Richard K. Passales*

Richard K. Passales  
Senior Counsel, Branch 4  
Office of Associate Chief Counsel  
(Corporate)

cc: