

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP-PLR127294-00
Date:
February 27, 2001

Distributing =

Controlled =

State A =

Shareholder #1 =

y =

z =

Dear:

This is in reply to a letter dated November 8, 2000, in which rulings were requested as to the federal income tax consequences of a proposed transaction. Additional information was submitted in a letter dated December 29, 2000. The facts submitted for consideration are substantially as set forth below.

Distributing is a State A corporation that has elected to be treated as a subchapter S corporation under Internal Revenue Code § 1361(a). Distributing is engaged in the y business. Shareholder #1 owns z % of Distributing's stock. Controlled is a newly formed corporation.

Financial information has been received indicating 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.

Disputes have arisen between Shareholder #1 and the other four shareholders of Distributing regarding the direction of the y market and how to respond. As a result

PLR127294-00

of these disputes, Shareholder #1 was removed as an officer and director of Distributing.

To resolve these management disputes, the following transactions have been proposed:

- i. Distributing will transfer \geq % of its assets and liabilities (the "Transferred Property") to Controlled in exchange for all of Controlled's stock.
- ii. Immediately after the transfer of the Transferred Property to Controlled, Distributing will distribute all of the Controlled stock to Shareholder #1 in exchange for all of Shareholder #1's Distributing stock.

In connection with the proposed transaction, it has been represented that:

- a. The fair market value of Controlled stock to be received by Shareholder #1 will be approximately equal to the fair market value of the Distributing stock surrendered by him in the exchange.
- 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 gross assets of Distributing used in the y business have a market value which is in excess of five percent (5%) of its gross assets, and after the proposed transaction, the gross assets of Distributing and Controlled which are used in the y business will have a fair market value which is in excess of five percent (5%) of each of Distributing's and Controlled's gross assets.
- d. The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- e. Following the proposed transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior to the proposed transaction.
- f. The distribution of the stock of Controlled is carried out for the following corporate business purpose: to separately allocate the management functions of the y business among the shareholders of Distributing to resolve management disputes. The Distribution of the stock of Controlled

PLR127294-00

is motivated, in whole or substantial part, by this corporate business purpose.

- g. Distributing is an S corporation (within the meaning of section 1361(a)). Controlled will elect to be an S corporation (within the meaning of section 1361(a)) on the first available date after the proposed transaction and there is no intent to revoke or otherwise terminate the S corporation election of Controlled.
- h. 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, Distributing or Controlled after the proposed transaction.
- i. There is no plan or intention by Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the proposed transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- j.
 - (1). Distributing and Controlled have no accumulated earnings and profits at the beginning of their respective taxable years;
 - (2). Distributing and Controlled will have no current earnings and profits as of the date of the distribution;
 - (3). 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; and
 - (4). Distributing is not aware of, nor is Distributing planning or intending, an event that will result in Distributing or Controlled having positive current or accumulated earnings and profits after the distribution.
- k. There is no plan or intention to liquidate Distributing or Controlled or to merge any of those corporations 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.
- l.
 - (i). The total adjusted bases 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; and
 - (ii) the liabilities assumed in the proposed 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. The income tax liability for the taxable year in which investment credit

PLR127294-00

property, if any (including any building to which § 47(d) applies), is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.

- n. Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the proposed transaction.
- o. No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the proposed transaction.
- p. 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.
- q. No two parties to the proposed transaction are investment companies as defined in section 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 section 355(e)), pursuant to which one or more persons will acquire (except as allowed by section 355(e)) directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock 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.

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

1. The transfer by Distributing to Controlled of the Transferred Property to newly created Controlled in exchange for Controlled common stock and the assumption by Controlled of certain related liabilities, followed by a distribution of the Controlled common stock by Distributing, as described above, will be a reorganization within the meaning of § 368(a)(1)(D) of the Code and Distributing and Controlled will each be "a party to the reorganization" within the meaning of § 368(b).
2. No gain or loss will be recognized by Distributing upon the transfer of the Transferred Property to Controlled in exchange for Controlled common stock. Sections 361(a) and 357 of the Code.
3. No gain or loss will be recognized by Controlled upon receipt of the Transferred Property from Distributing in exchange for Controlled common stock. Section 1032(a) of the Code.

PLR127294-00

4. The basis of the Transferred Property received by Controlled will be the same as the basis of such property in the hands of Distributing immediately prior to the transfer. Section 362(b) of the Code.
5. The holding period of the Transferred Property received by Controlled will include the period during which such property was held by Distributing. Section 1223(2) of the Code.
6. No gain or loss will be recognized to (and no amount shall be includible in the income of) Shareholder #1 upon receipt of the Controlled stock in the distribution described above. Section 355(a)(1) of the Code.
7. No gain or loss will be recognized by Distributing upon the distribution of all of its stock of Controlled as described above. Section 361(c) of the Code.
8. The basis of the Controlled stock in the hands of Shareholder #1 immediately after the distribution of Controlled stock to Shareholder #1 will be the same as Shareholder #1's basis in the Distributing stock surrendered in exchange. Section 358(a)(1) of the Code.
9. The holding period of the Controlled stock received by Shareholder #1 in the transaction will include his holding period of the Distributing stock, provided that such stock is held as a capital asset on the date of the distribution. Section 1223(1) of the Code.
10. As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) of the regulations.

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. Specifically, we express no opinion as to whether Distributing's S corporation election is valid or whether an election of S corporation treatment by Controlled will be valid.

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.

PLR127294-00

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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

Sincerely,
Jasper L. Cummings
Associate Chief Counsel
By: Charles M. Levy, Reviewer, CC:CORP:2