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Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:6-PLR-116619-00

Date:

March 2, 2001

Legend

Distributing =

Controlled =

Company Name 1 =

Company Name 2
("Controlled") =

Affiliate Corp. 1 =

Unrelated Corp. 1 =

Unrelated Corp. 1
Transaction =

Affiliate Corp. 1
Agreement =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

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Shareholder E =

Shareholder F =

Shareholder G =

Shareholder H =

Shareholder I =

Business A =

Product A =

Business B =

The First Business
B Shareholders
Agreement =

The Second Business
B Shareholders
Agreement =

State A =

Decade 1 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

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Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

Date 11 =

Date 12 =

Date 13 =

Date 14 =

Date 15 =

\$a =

\$b =

\$c =

#a =

#b =

#c =

#d =

#e =

#f =

#g =

#h =

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#j =

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%e =

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%g =

%h =

%i =

This is in response to your authorized representative's letter dated August 25, 2000, requesting rulings under §§ 351 and 355 of the Internal Revenue Code (the "Code") with respect to a proposed series of transactions. Additional information was received in subsequent letters and facsimiles. The material information submitted is summarized below. Certain of the proposed or contemplated actions in the letter ruling request have since occurred or been consummated; however, to avoid confusion the tense of any such statements and representations have not been changed herein.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the factual information, representations, and other data may be required as part of the audit process.

Distributing in general

Distributing was incorporated in State A on Date 1. Distributing files its federal income tax return on a calendar year basis using the accrual method of accounting. Distributing made a Subchapter S election effective Date 2.

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Distributing has one class of stock with a total of #a shares outstanding. The stock is voting common stock having no dividend or liquidation preferences or limitations. There are no other securities or other outstanding interests in the nature of bonds, debentures, notes, warrants, options, puts, etc. that could be considered a stock interest in Distributing. The stock of Distributing is owned as follows:

<u>Shareholder</u>	<u>Number of Shares</u>	<u>Percent</u>
A	#b	%a
B	#c	%b
C	#c	%b
D	#c	%b
E	#c	%b
F	#d	%c
G	#e	%d
H	#c	%b
I	#c	%b
Totals	#a	100.0000%

Shareholders A and B are husband and wife. Shareholders C, D, and E are the daughters of shareholders A and B. Shareholders F and G were formerly husband and wife, but are now divorced. Shareholders H and I are the son and daughter, respectively, of shareholders F and G.

Distributing is engaged in the operation of two distinct businesses, which are Business A and Business B. Distributing has been engaged in both Business A and Business B for more than fifteen years. Business A has employed more than 50 full-time employees at all times during each of the past five years. Business B has employed more than 50 full-time employees at all times during each of the past five years. Financial information has been received indicating 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 last five years.

Affiliate of Distributing Sold

In the late Decade 1, Affiliate Corp. 1 was organized as an affiliate of Distributing to handle certain business activity. All of the shareholders of Distributing were

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shareholders of Affiliate Corp. 1. (There were also several shareholders of Affiliate Corp. 1 who are not and never have been shareholders of Distributing). Affiliate Corp. 1 has been a major customer of Business A, and has historically accounted for a large percentage of Distributing's sales of Product A. Effective Date 3, Affiliate Corp. 1 was acquired by Unrelated Corp. 1 as a wholly owned subsidiary by merging a wholly owned subsidiary of Unrelated Corp. 1 into Affiliate Corp. 1 in a tax free reorganization under Code Section 368(a)(1)(A) by means of Code Section 368(a)(2)(E), pursuant to which the shareholders of Affiliate Corp. 1 exchanged all of their Affiliate Corp. 1 stock for stock of Unrelated Corp. 1 (the "Unrelated Corp. 1 Transaction").

On Date 3, in conjunction with the Unrelated Corp. 1 Transaction, Distributing and its shareholders entered into an agreement with Affiliate Corp. 1 (the "Affiliate Corp. 1 Agreement"). The Affiliate Corp. 1 Agreement is an exclusive purchase agreement by and between Distributing and Affiliate Corp. 1 which provides that Affiliate Corp. 1 shall purchase exclusively from Distributing all of Affiliate Corp. 1's requirements for custom Product A, and other products used in connection with Affiliate Corp. 1's business. The Affiliate Corp. 1 Agreement further provides that Affiliate Corp. 1 shall contract exclusively with Distributing for its requirements for third party development of prototype molds and tooling for the design of Product A and for third party technical, development and engineering services in connection with Product A (collectively referred to as "Services"). In consideration of Affiliate Corp. 1's agreements, Distributing agrees to the limitations and restrictions to sell, lease, license or otherwise provide to any third party, other than Affiliate Corp. 1 or an affiliate of Affiliate Corp. 1, Product A, Services, contract packaging or manufacturing services or Intellectual Property. The Affiliate Corp. 1 Agreement also provides for the assignment by Affiliate Corp. 1 of its machine sales division to Distributing and the transfer of the web page content relating to Affiliate Corp. 1's machine sales division. The Affiliate Corp. 1 Agreement was executed as of the effective date of the Unrelated Corp. 1 Transaction.

In conjunction with the Unrelated Corp. 1 Transaction, Distributing and Shareholder A, as the Affiliate Corp. 1 Stockholders Representative, entered into an Indemnification Agreement, dated Date 3, whereby Distributing indemnifies and holds harmless the Affiliate Corp. 1 stockholders from any and all liability with respect to the Agreement and Plan of Merger for the Unrelated Corp. 1 Transaction, dated Date 13, under which Affiliate Corp. 1 makes certain representations and warranties to Unrelated Corp. 1, including some representations and warranties concerning Distributing.

Controlled in general

Controlled was incorporated in State A on Date 4, to effectuate the proposed transaction. Controlled was established under the name Company Name 1, but changed its name to "Company Name 2 ("Controlled")" on Date 5.

Controlled was initially capitalized on Date 6, when Distributing transferred \$1,000 to

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Controlled in exchange for all of the stock of Controlled. Controlled has one class of stock, which is voting common stock having no dividend or liquidation preferences or limitations, all of which is currently owned by Distributing. There will be no other securities or other outstanding interests in the nature of bonds, debentures, notes, warrants, options, puts, etc. that could be considered a stock interest in Controlled.

On Date 7, Distributing elected to have Controlled treated as a qualified Subchapter S subsidiary ("QSub"), effective as of the date of incorporation of Controlled. Pursuant to Rev. Proc. 98-55, 1998-2 C.B. 643, Distributing subsequently filed a Form 8869, Qualified Subchapter S Subsidiary Election, to change the effective date of the QSub election for Controlled to Date 6.

Buy-sell agreements

There are two shareholder buy-sell agreements. The first, dated Date 8 and subsequently amended, is by and between Distributing and all of its shareholders A through I listed above (the "Original Shareholders Agreement"). The second, dated Date 9, is by and between Distributing and shareholder G (the "Second Shareholders Agreement"). A third shareholder agreement, dated Date 10, by and between Distributing and all of the shareholders A through I listed above (the "Split Off Agreement"), was executed in anticipation of the transactions for which this letter ruling was requested.

In respect to the Original Shareholders Agreement and the Second Shareholders Agreement, the Split-Off Agreement provides that as of the closing of the transactions contemplated therein, and for which this letter ruling was requested (the "Closing Date"), (a) the Original Shareholders Agreement and the Second Shareholders Agreement will be terminated by the appropriate parties, as provided in the respective Agreements, (b) all parties agree to waive all obligations of each other under the respective Agreements, and (c) all parties agree to permit the transactions contemplated therein, and for which this letter ruling was requested.

For the limited purposes of agreeing to the provisions of Section 13 of the Affiliate Corp. 1 Agreement, all the shareholders of Distributing also entered into the Affiliate Corp. 1 Agreement. Pursuant to Section 13, Distributing and each of its shareholders agree that Distributing will not sell any of Distributing's assets and Distributing's shareholders agree that they will not dispose of any of their Distributing capital stock, except (a) by redemption, (b) gifts or transfers to family members, or (c) subject to a right of first refusal by Affiliate Corp. 1. Both Affiliated Corp. 1 and Unrelated Corp. 1 have consented to the transactions for which this letter ruling was requested.

Reason for split-off

Serious disputes have arisen between the two major shareholders of Distributing, specifically shareholders A and F, which are having an adverse effect on the day-to-day

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operations of Distributing. Historically, shareholder A has served as Chairman of Distributing and shareholder F has served as President. Corporate governance, management and operational issues simply cannot be resolved effectively as long as shareholders A and F are significant shareholders of Distributing.

The following transaction has been proposed:

- (i) Distributing will transfer to Controlled all of the assets of Business B, subject to the assumption by Controlled of certain liabilities associated with Business B, as a contribution to capital. Distributing may transfer, or hold back, certain cash or receivables in order to assure that the fair market value of the Controlled stock received by the shareholders to whom such stock is distributed will be approximately equal to the fair market value of the stock of Distributing surrendered by such shareholders in the exchange of Distributing stock for Controlled stock.
- (ii) Distributing will distribute all of the stock of Controlled held by Distributing immediately before the distribution, to the group of shareholders consisting of shareholders F, G, H, and I (collectively, the "Business B shareholders") in exchange for all of the shares of Distributing held by the Business B shareholders. No other securities will be distributed.

It is contemplated that the entire distribution will be effective as of midnight on Date 11 (which date is within one year from the date Controlled was formed).

The following representations have been made in connection with the proposed transaction:

- (a) Neither Distributing nor Controlled has any foreign shareholders.
- (b) Except for the formation and initial capitalization of Controlled, Distributing will not modify its ownership of Controlled stock within the 5-year period preceding the distribution.
- (c) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to eliminate the problems generated by the shareholder disputes and to enhance the success of Business A and Business B by allowing shareholders A, B, C, D, and E to focus on Business A without having to deal with Business B and shareholders F, G, H, and I, and conversely allowing shareholders F, G, H, and I to focus on Business B without having to deal with Business A and shareholders A, B, C, D, and E. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (d) No shares of stock or securities of Controlled will be retained and held by

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Distributing after the distribution. Nor does or will Distributing hold any options to acquire stock in Controlled.

- (e) Controlled will not be indebted to Distributing after the distribution of Controlled stock.
- (f) The distribution of Controlled stock will not be pro rata with respect to the shareholders of Distributing. Only the Business B shareholders will receive Controlled stock. The Business B shareholders will receive Controlled stock in proportion to their stockholdings in Distributing immediately prior to the distribution.
- (g) The number of shares and the percentage interest of the single class of common voting stock outstanding in Distributing and Controlled that will be owned by each shareholder immediately after the distribution is as follows:

Distributing		
<u>Shareholder</u>	<u>Number of Shares</u>	<u>Percent</u>
A	#b	%e
B	#c	%f
C	#c	%f
D	#c	%f
E	#c	%f
Totals	#f	100.0000%

Controlled		
<u>Shareholder</u>	<u>Number of Shares</u>	<u>Percent</u>
F	#g	%g
G	#h	%h
H	#i	%i
I	#i	%i
Totals	#j	100.0000%

- (h) No shareholders of Distributing will receive any securities of Controlled, other than the common stock listed above.

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- (i) The fair market value of the controlled corporation stock and other consideration to be received by each shareholder of the distributing corporation will be approximately equal to the fair market value of the distributing corporation stock surrendered by the shareholder in the exchange.
- (j) No part of the consideration to be distributed by the distributing corporation will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation (Distributing).
- (k) No shareholder or security holder of Distributing will transfer or surrender any property in the transaction other than stock of Distributing.
- (l) Business A has been continuously conducted, within the meaning of Treas. Reg. section 1.355-3(b), by Distributing for the 5-year period ending on the date of the proposed distribution. Business A has been conducted by Distributing since the late Decade 1.
- (m) The Affiliate Corp. 1 Agreement, which provides that Affiliate Corp. 1 shall purchase Product A exclusively from Distributing, and also provides certain limitations and restrictions regarding Distributing's ability to contract with and sell to third parties, particularly competitors of Affiliate Corp. 1, will not materially change the business operations of Distributing since the Affiliate Corp. 1 Agreement essentially provides for the continuation of the relationship of the two companies when they were affiliates. Affiliate Corp. 1 continues to be a major customer of Distributing, and it is not anticipated that the Unrelated Corp. 1 Transaction will adversely affect the operations of Business A.
- (n) The preceding 5-year period does not include any time during which there was no business activity, or a significant amount of time during which there was a substantial reduction in business activity.
- (o) None of the real property, intellectual property and other intangible property which has historically been occupied or used by Business A will be separated from Business A. Such property will be retained by Distributing.
- (p) The five years of financial information submitted on behalf of the distributing corporation 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.

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- (q) Business B has been continuously conducted, within the meaning of Treas. Reg. section 1.355-3(b), by Distributing for the 5-year period ending on the date of the proposed distribution.
- (r) There have been no substantial changes in the business activities of Business B during the preceding 5-year period. The Unrelated Corp. 1 Transaction did not have any direct effect on the operations of Business B. The preceding 5-year period does not include any time during which there was no business activity, or a significant amount of time during which there was a substantial reduction in business activity.
- (s) None of the real property, intellectual property and other intangible property which has historically been occupied or used by Business B will be separated from Business B. Such property will be transferred to and retained by Controlled.
- (t) Each of Distributing and Controlled will be directly engaged in an active business and neither will be so engaged indirectly through ownership of stock and securities in one or more other corporations immediately after the distribution.
- (u) No active business that is or will be directly conducted by Distributing or Controlled (or any other corporation) has been acquired by that corporation during the 5-year period ending on the date of the proposed distribution, except for the transfer of the assets of Business B from Distributing to Controlled as a contribution to capital.
- (v) Neither Distributing nor Controlled has owned the stock of any other corporation continuously for the 5-year period ending on the date of the proposed distribution. No stock of any corporation other than Controlled was acquired by Distributing, Controlled, or any other corporation during the 5-year period ending on the date of the proposed distribution.
- (w) On Date 9, shareholder F transferred #e shares of Distributing stock to shareholder G pursuant to the terms of their Divorce and Marital Property Settlement Agreement. On the same date, Distributing redeemed #c shares of Distributing stock from shareholder G which shareholder G had previously owned in her own name. The redemption price was \$a per share, based upon the Company's book value per share for the fiscal year ending Date 12, as provided in the Original Shareholders Agreements.
- (x) Following the transaction, the distributing and controlled corporations will each continue the active conduct of its business, independently and with its separate employees in separate facilities.

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- (y) For an interim period after the distribution, and until Distributing is able to provide for all administrative, shipping and receiving functions with its own employees, those functions will be performed for Distributing by employees of Controlled at facilities maintained by Controlled, and Distributing will reimburse Controlled for these services. Reimbursements will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (z) It is not contemplated that Distributing or any of its employees will be providing services for Controlled. If any such services are provided by Distributing or any of its employees for Controlled, Controlled will reimburse Distributing for such services, and such reimbursements will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (aa) There are no planned or intended substantial reductions in business activity for any active business.
- (bb) The purpose for the distribution does not include the facilitation of personal planning of any shareholder.
- (cc) The distributing corporation is an S corporation (within the meaning of Code Section 1361(a)), having made its S election effective Date 2. Prior to that date the distributing corporation was a C corporation with accumulated earnings and profits. The controlled corporation is a QSub. The controlled corporation will elect to be an S corporation pursuant to Code Section 1362(a) and Treas. Reg. section 1361-5(c)(2) and there is no plan or intent to revoke or otherwise terminate the S corporation election of either the distributing or controlled corporation.
- (dd) No reduction in federal taxes of Distributing, Controlled, or any other corporation is expected to result from the transaction.
- (ee) The Business A shareholders intend to continue to operate Distributing as a Subchapter S corporation. The Business B shareholders intend to have Controlled elect to be a Subchapter S corporation effective as of the date of the distribution, and each of the Business B shareholders has agreed to consent to such an election.
- (ff) There is no plan or intention by the shareholders of the distributing corporation to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either the distributing or controlled corporation after the transaction.
- (gg) There is no plan or intention by either the distributing corporation or the

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controlled corporation, 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.

- (hh) There is no plan or intent to dispose of the stock or securities of either Distributing or Controlled, other than the distribution of the stock of Controlled by Distributing to the Business B shareholders, and the exchange of their stock of Distributing by the Business B shareholders for the stock of Controlled, as described in the letter ruling request.
- (ii) Distributing does not have any inactive assets.
- (jj) Distributing has investment assets. The investment assets are marketable securities—primarily high grade corporate bonds. As of Date 14, Distributing had \$b of marketable securities, which amount equaled approximately 10-percent of Distributing's total assets. As of Date 15, Distributing had \$c of marketable securities, which amount equaled approximately 18-percent of Distributing's total assets.
- (kk) As of the Closing Date, final adjustments will be made pursuant to which Distributing will transfer to Controlled, or hold back, certain cash, marketable securities or receivables, so that after final adjustment, each company will have adequate working capital as of the Closing Date. The final adjustment will be an allocation of any remaining marketable securities in such amounts as are required to assure that the fair market value of the Controlled stock to be received by the Business B shareholders will be approximately equal to the fair market value of the Distributing stock to be surrendered by the Business B shareholders in the exchange of Distributing stock for Controlled stock.
- (ll) These assets will be allocated between Distributing and Controlled after the allocation of the Business A and Business B assets in a manner to assure that the fair market value of the Controlled stock received by the shareholders to whom such stock is distributed will be approximately equal to the fair market value of the stock of Distributing surrendered by such shareholders in the exchange of Distributing stock for Controlled stock.
- (mm) There is no plan or intention to liquidate either the distributing or controlled corporation, 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.
- (nn) After the distribution, the Business A shareholders will own 100% of the

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stock of Distributing and the Business B shareholders will own 100% of the stock of Controlled.

- (oo) None of the outstanding stock of Distributing or Controlled was acquired by purchase during the 5-year period ending on the date of the proposed distribution. The only stock acquired during that period was the #e shares of Distributing owned by shareholder G that was transferred to her from shareholder F pursuant to the terms of their Divorce and Marital Property Settlement Agreement on Date 9. Shareholder G's basis in those shares is the same as shareholder F's adjusted basis immediately prior to the transfer.
- (pp) The total adjusted bases and the fair market value of the assets transferred to the controlled corporation by the distributing corporation each equals or exceeds the sum of the liabilities assumed by the controlled corporation plus any liabilities to which the transferred assets are subject.
- (qq) 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.
- (rr) No investment credit determined under Code Section 46 has been or will be claimed with respect to any property being transferred between Distributing and Controlled.
- (ss) It is anticipated that receivables from Business B customers and partially completed contracts for Business B customers will be transferred from Distributing to Controlled. However, the matching of income and deductions will not be distorted pursuant to these transfers, as Distributing shall have recognized income earned and deductions incurred prior to any such transfer under the accrual method of accounting and/or the percentage-of-completion method for long-term contracts. Income on partially completed contracts will be recognized by Controlled only for that portion of the performance period for each such contract following any such transfer.
- (tt) The transaction will not involve or result in a situation in which one party recognizes income but another party recognizes the deductions associated with such income or one party owns property but another party recognizes the income associated with such property. No income items, or any items resulting from a sale, exchange or disposition, that would have resulted in income to Distributing, or any items of expense, will be transferred to Controlled.

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- (uu) The distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (vv) No indebtedness has been or will be canceled in connection with the transaction.
- (ww) No intercorporate debt will exist between the distributing corporation and the controlled corporation at the time of, or subsequent to, the distribution of the controlled corporation stock.
- (xx) None of the transactions contemplated involve the distribution of stock from one member of an affiliated group, as defined in Code section 1504(a), to another member of such group.
- (yy) Payments made in connection with all continuing transactions, if any, between the distributing and controlled corporations, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (zz) No two parties to the transaction are investment companies as defined in Code Section 368(a)(2)(F)(iii) and (iv).
- (aaa) No money or other property will be received by Distributing in connection with the transaction.
- (bbb) Neither Distributing, Controlled nor any Other Corporation is a foreign corporation.
- (ccc) There have not been, and will not be, any other related transactions, other than those described herein.
- (ddd) 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 directly or indirectly stock possessing 50% or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50% or more of the total value of all classes of stock of either Distributing or Controlled.
- (eee) Controlled is a party to the Split-Off Agreement. Immediately prior to the distribution, Controlled will have no other shareholder agreements.
- (fff) The Business B shareholders intend to execute two shareholders agreements (the "First Business B Shareholders Agreement" and the "Second Business B Shareholders Agreement").

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- (ggg) The First Business B Shareholders Agreement will provide that in the event any of shareholders F, H and I desires to transfer any shares of stock of Controlled (other than permitted transfers to grantor trusts or family members) the remaining shareholders (other than shareholder G) or Controlled shall purchase such shares, the purchase price being the book value of the shares being sold, determined as of the end of the immediately preceding fiscal year of the company.
- (hhh) The Second Business B Shareholders Agreement will provide that, in respect to shareholder G's shares of Controlled stock that she will receive in exchange for the shares of Distributing transferred to shareholder G from shareholder F pursuant to the terms of their Divorce and Marital Property Settlement Agreement, (a) in the event shareholder G desires to transfer any such shares (other than permitted transfers to grantor trusts or family members) Controlled shall purchase the shares at a price equal to their book value, and (b) in the event that shareholder F sells any of his shares to Controlled, shareholder G shall be required to sell, and Controlled shall be required to purchase, a percentage of her shares equal to the percentage of shareholder F's shares purchased by Controlled, at the same price and on the same terms and conditions.
- (iii) The Business A Shareholders intend to execute a new Shareholders Agreement (the "New Business A Shareholders Agreement") immediately after the distribution. The New Business A Shareholders Agreement will provide that in the event any shareholder desires to transfer any shares of stock of Distributing (other than permitted transfers to grantor trusts or family members), Distributing or the remaining shareholders of Distributing shall have the right of first refusal to purchase such shares. In the case of a proposed transfer to a third party in an arm's length transaction, the purchase price shall be equal to the price negotiated with the prospective purchaser. In the case of any other voluntary or involuntary transfer, the purchase price shall be the book value of the shares being sold, determined as of the end of the immediately preceding fiscal year of the company.

Based solely on the information submitted and on the representations made, it is held as follows:

(1) The transfer by Distributing to Controlled of the assets described above solely in exchange for all of the stock of Controlled and the assumption of certain liabilities, as described above, followed by the distribution of the Controlled stock to F, G, H, and I in exchange for all of their Distributing stock, will be a reorganization within the meaning of section 368(a)(1)(D) of the Internal Revenue Code of 1986. Distributing and Controlled will each be "a party to a reorganization" within the meaning of section 368(b).

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(2) No gain or loss will be recognized to Distributing upon the transfer of assets, subject to liabilities, to Controlled in exchange for Controlled stock, as described above. Sections 361(a) and 357(a).

(3) No gain or loss will be recognized to Controlled on the receipt of the assets in exchange for Controlled stock, as described above. Section 1032(a).

(4) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the transaction described above. Section 362(b).

(5) The holding period of the Distributing assets received by Controlled will include the period during which such assets were held by Distributing. Section 1223(2).

(6) No gain or loss will be recognized to Distributing upon the distribution of its Controlled stock to the exchanging shareholders, pursuant to the plan of reorganization, as described above. Section 361(c)(1).

(7) No gain or loss will be recognized to (and no amount will be included in the income of) F, G, H, and I upon the receipt of the Controlled stock in exchange for all of their Distributing stock, as described above. Section 355(a)(1).

(8) The basis of the Controlled stock in the hands of F, G, H, and I will, in each instance, be the same as the basis of the Distributing stock surrendered in exchange therefor. Section 358(a)(1).

(9) The holding period of the Controlled stock received by F, G, H, and I will, in each instance, include the holding period of the Distributing stock surrendered in exchange therefor, provided that such stock is held as a capital asset on the date of the exchange. Section 1223(1).

(10) As provided in section 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made under section 1.312-10(a) of the Income Tax Regulations.

(11) Distributing's accumulated adjustments account immediately before the transaction will be allocated between Distributing and Controlled in a manner similar to the manner in which Distributing's earnings and profits will be allocated under section 312(h). Treas. Reg. § 1.1368-2(d)(3).

(12) Controlled will be subject to section 1374 with respect to any asset transferred by Distributing to Controlled to the same extent Distributing was subject to section 1374 with respect to any such asset. For purposes of section 1374, Controlled's recognition period will be reduced by the portion of Distributing's recognition period that elapses prior to Distributing's transfer of any such asset to Controlled. Ann. 86-128, 1986-51

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(13) The distribution of Controlled to the Business B shareholders will terminate the QSub election with respect to Controlled. Section 1361(b)(3)(B); Treas. Reg. § 1.1361-5(a)(1)(iii). Controlled may, without requesting the Commissioner's consent, make an S election with respect to it before the expiration of the five-year period described in section 1361(b)(3)(D) and Treas. Reg. section 1.1361-5(c)(1), provided that: (i) Immediately following the termination, Controlled (or its successor) is otherwise eligible to make an S election; and (ii) the election is made effective immediately following the termination of the QSub election. Treas. Reg. § 1.1361-5(c)(2) (Treas. Reg. § 1.1361-5(c)(3), Example 1, providing that the election may be made as of the date of the stock distribution without requesting the Commissioner's consent.)

(14) Any momentary ownership by Distributing of the stock of Controlled, on the day of termination of the QSub election, in connection with a corporate separation to which Code Section 368(a)(1)(D) applies, will not, in and of itself, prohibit Controlled from being eligible under Code Section 1361(b) to make an S election under Code Section 1362(a), provided it satisfies the other requirements for making an election. Cf. Treas. Reg. § 1.1361-5(c)(3), Example 1.

(15) Distributing will not be required to consent to Controlled's S election because of any momentary ownership of Controlled by Distributing resulting from the termination of Controlled's QSub election. Cf. Treas. Reg. § 1.1361-5(c)(3), Example 1; Rev. Rul. 72-320, 1972-1 C.B. 270.

(16) Any momentary ownership by Distributing of the stock of Controlled, on the day of termination of the QSub election, will not, in and of itself, terminate the S election of Controlled under Code Section 1362(d)(2)(A). Cf. Treas. Reg. § 1.1361-5(c)(3), Example 1.

No opinion is expressed as to the tax treatment of the transactions under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings. No opinion is expressed as to whether Distributing's S corporation election is valid or whether Controlled's QSub election is valid. No opinion is expressed as to whether Controlled is otherwise eligible to elect to be an S corporation and whether the election will be valid under section 1362(a).

Furthermore, no opinion is expressed with respect to the assignment of the machine sales division pursuant to the Affiliate Corp. 1 Agreement.

In accordance with a power of attorney on file in this office, copies of this letter are being sent to your authorized representatives.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of

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the Code provides that it may not be used or cited as precedent.

Sincerely,
Assistant Chief Counsel (Corporate)

By: *Alfred C. Bishop*
Branch Chief (CC:CORP:B6)
