

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

June 15, 2001

LEGEND:

S Corporation =

Newco =

LLC 1 =

LLC 2 =

Shareholder A =

Minority Investors =

Country X =

State A =

State B =

Date A =

Date B =

\$A =

A% =

B% =

Line of Service A =

Business A =

This letter responds to your authorized representative's letter dated January 9, 2001, in which rulings were requested as to certain federal income tax

consequences of a proposed transaction. Additional information was submitted in a letter dated June 14, 2001.

Summary of Facts

S Corporation, an S corporation for Federal and State A income tax purposes, was organized in State A on Date A. S Corporation provides management services to LLC 1 through a management agreement between the two entities.

S Corporation employs Shareholder A, its largest shareholder, to provide services to LLC 1. LLC 1 is currently a State A limited liability company organized by S Corporation on Date B and is treated as a partnership for Federal and state tax purposes.

After forming LLC 1, S Corporation transferred all of its assets and liabilities to LLC 1. LLC 1 provides Line of Service A to Business A in the U.S. and Country X. S Corporation currently owns A% of LLC 1's outstanding membership interests. Other investors (the "Minority Investors") own the remaining B% of the membership interests.

For what the taxpayer represents are valid business reasons, the following transaction is proposed:

S Corporation and LLC 1 plan to facilitate LLC 1's ability to raise additional capital by merging S Corporation with and into a newly formed corporation ("Newco"), and transferring the remaining interests of LLC 1 to Newco.

S Corporation will form Newco as a State B corporation. Newco will be a C corporation for Federal and State B income tax purposes. S Corporation will merge into Newco with Newco surviving. In the merger, Newco will acquire S Corporation assets, including S Corporation's A% interest in LLC 1 and Newco stock will be distributed to the former shareholders of S Corporation. Newco will form LLC 2, a State A limited liability company. Newco will contribute B% of its stock to LLC 2, the value of which will equal the value of the Minority Investors' interests they held in LLC 1. LLC 2 will merge into LLC 1. As a result of the merger of LLC 2 into LLC 1, the LLC 1 Minority Investors will, by operation of law, be treated as transferring their interests in LLC 1 to Newco in exchange for B% of the Newco stock.

The effect of all the steps of the transaction will be that LLC 1 will become a wholly owned entity of Newco, and Newco will transfer solely its voting stock to the former Minority Investors of LLC 1 in exchange for their LLC 1 interests. As a result of the proposed transaction, Newco will be owned B% by the former LLC 1 Minority Investors and A% by the former shareholders of S Corporation. Then LLC 1 (which was previously treated as a partnership) will be treated as liquidating into Newco since it will become a disregarded entity when it becomes wholly owned by Newco.

Soon after Newco's creation and consummation of the proposed transaction,

Newco intends to sell shares of its stock, worth \$A, by private offering pursuant to a best-efforts underwriting agreement, and Newco may sell additional shares by public offering when it needs to raise more capital.

Representations

The taxpayer has made the following representations about the proposed transaction:

(a) No stock or securities will be issued for services rendered to or for the benefit of the transferee in connection with the proposed transaction, and no stock or securities will be issued for indebtedness of the transferee that is not evidenced by a security or for interest on indebtedness of the transferee which accrued on or after the beginning of the holding period of the transferor(s) (Minority Investors and S Corporation) for the debt.

(b) None of the assets to be transferred were received by the transferor(s) (Minority Investors and S Corporation) as part of a plan of liquidation of another corporation.

(c) No income items, such as accounts receivable or commissions due, are being transferred to the transferee (Newco).

(d) The transferors' interests in LLC 1 or in LLC 1's assets will be transferred to Newco and LLC 1 will be liquidated.

(e) The transferors will not retain any significant power, right, or continuing interest, within the meaning of § 1253(b) of the Code, in the franchises, trademarks or trade names being transferred.

(f) The transfer is not the result of the solicitation by a promoter, broker, or investment house.

(g) The transferor(s) will not retain any rights in the property transferred to the transferee.

(h) The transferor(s) will not transfer any licenses, leases, etc. to Newco in exchange for stock or securities.

(i) No property transferred to Newco will be leased back to any Transferor, other Newco shareholder, or a related party.

(j) The value of the stock received in exchange for accounts receivable will be equal to the net value of the accounts transferred, i.e. the face amount of the accounts receivable previously included in income less the amount of the reserve for bad debts.

(k) The adjusted basis and the fair market value of the assets to be transferred by the Minority Investors to the transferee will, in each instance, be equal to or exceed the sum of the liabilities to be assumed by the transferee plus any liabilities to which the transferred assets are subject.

(l) The liabilities of the transferor(s) to be assumed by the transferee were incurred in the ordinary course of business and are associated with the assets to be transferred.

(m) There is no indebtedness between the transferee and the transferor(s) and there will be no indebtedness created in favor of the transferor(s) as a result of the transaction.

(n) All of the common stock of Newco will be issued to LLC 1's Minority Investors and to S Corporation's shareholders, as described above, in the transaction.

(o) All exchanges will occur on approximately the same date.

(p) Newco will issue common stock and/or preferred stock to the private investors pursuant to the private offering noted above. No other property in addition to the common and preferred stock will be issued to the private investors.

(q) Additional common stock will be issued to the public investors if Newco engages in a public stock offering, as noted above.

(r) There is no plan or intention on the part of the transferee to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.

(s) Taking into account any issuance of additional shares of transferee stock (other than stock issued pursuant to the private offering and potential public offering noted above); any issuance of stock for services; the exercise of any transferee stock rights, warrants, or subscriptions; a public offering of transferee stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of the transferee to be received in the exchange, the transferor(s) will be in "control" of the transferee within the meaning of § 368(c) of the Code.

(t) Each transferor will receive stock approximately equal to the fair market value of the property each transferred to the transferee.

(u) The transferee will remain in existence and retain and use the property transferred to it in a trade or business.

(v) There is no plan or intention by the transferee to dispose of the transferred property other than in the normal course of business operations.

(w) Each of the parties to the transaction will pay its or his/her own expenses, if any, incurred in connection with the proposed transaction.

(x) The transferee will not be an investment company within the meaning of § 351(e)(1) of the Code and § 1.351-1(c)(1)(ii) of the regulations.

(y) The transferors are not under the jurisdiction of a court in a title 11 or similar case (within the meaning of § 368(a)(3)(A)) and the stock or securities received in the exchange will not be used to satisfy the indebtedness of such debtor.

(z) The transferee will not be a "personal service corporation" within the meaning of § 269A of the Code.

(aa) The merger of S Corporation with and into Newco, viewed independently of the other steps in the proposed transaction, will qualify as a reorganization under § 368(a)(1)(A) of the Code.

(bb) The organization of Newco and the merger of S Corporation into Newco will not occur solely for the purpose of enabling LLC 1's Minority Investors to transfer their membership interest in LLC 1 without the recognition of gain.

(cc) S Corporation has organized Newco in State B because it believes that the laws of State B are more favorable to corporations than are the laws of State A, and that, following the merger of S Corporation into Newco, those laws will facilitate Newco's efforts to obtain additional capital from potential investors.

Rulings

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

(1) The transfer by S Corporation of its property to Newco in the merger and, the transfer by the Minority Investors in LLC 1 of their interests in LLC 1 to Newco, will be considered together as a transaction under § 351(a).

(2) The Minority Investors will recognize no gain or loss on the transfer of their interests in LLC 1 to Newco solely in exchange for Newco stock and the assumption by Newco of liabilities (§§ 351(a) and 357(a)).

(3) Under § 358(a) of the Code, the basis to the Minority Investors of the Newco stock received in exchange for their LLC 1 interests will equal the basis of their LLC 1 interests transferred to Newco, reduced by their share of LLC 1's liabilities assumed by Newco plus any liabilities to which the transferred assets are subject (§§ 752(d) and 358(d)).

(4) The holding period of the stock to be received by the Minority Investors will

include the Minority Investors' holding period for which they owned interests in LLC 1 provided that such property constitutes a capital asset as defined in § 1221 or property described in § 1231 on the date of the exchange (§ 1223(1)).

(5) S Corporation will recognize no gain or loss on the transfer of its interests in LLC 1 to Newco solely in exchange for Newco stock and the assumption by Newco of liabilities, except to the extent S Corporation's share of LLC 1's liabilities exceeds S Corporation's basis in LLC 1 (§§ 351(a), 357(a), and 357(c)).

(6) Newco will recognize no gain or loss on the receipt of LLC 1 interests from either the Minority Investors or S Corporation in exchange for Newco stock (§ 1032(a)).

(7) Newco's basis in the LLC 1 interests transferred by the transferors (S Corporation and the Minority Investors) will equal the basis of such interests in the hands of the transferors immediately before the transfer, increased by the amount of any gain recognized by S Corporation on the transfer (§ 362(a)).

(8) Newco's holding period for each LLC 1 interest received from the transferors (S Corporation and the Minority Investors) will include the holding period of the LLC 1 interest in the hands of the transferors immediately before the transfer (§ 1223(2)).

(9) Newco will not recognize gain or loss on the receipt of the assets and liabilities of LLC 1 upon LLC 1's liquidation, except to the extent that any money distributed exceeds the adjusted basis of Newco's interest in LLC 1 immediately before the distribution in which case it will recognize gain in the amount of such excess (§ 731(a)).

(10) LLC 1 will not recognize gain or loss on its liquidation (§ 731(b)).

(11) Newco's basis in the assets distributed by LLC 1 in liquidation of LLC 1 to Newco shall be an amount equal to the adjusted basis of Newco's interest in LLC 1 reduced by any money distributed to it from LLC 1 (§ 732(b)).

(12) Newco's holding period in the LLC 1 assets will include the period such assets were held by LLC 1 (§§ 735(b) and 1223(2)).

Caveats and Procedural Statements

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.

This ruling is directed only to the taxpayer 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.

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

Sincerely,
Associate Chief Counsel (Corporate)
By: Alfred C. Bishop, Jr.
Chief, Branch 6