

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

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In Re:

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Date:

December 24, 2003

LEGEND

Distributing =

Controlled =

Expert =

Consultant =

Attorney =

Date1 =

Date2 =

Products =

Business1 =

Business2 =

Business3 =

Business4 =

Business5 =

Business6 =

Business7 =

Business8 =

a =

Dear :

This letter responds to a request for rulings on certain federal income tax consequences of a proposed transaction (“Request”) submitted on behalf of Distributing dated August 7, 2003. Additional information was subsequently submitted by mail and facsimile. The rulings in this letter are based on the facts and representations submitted under penalties of perjury in support of the Request. Verification of that information may be required as part of the audit process. The material information is summarized below.

Distributing was incorporated on Date1 (more than 5 years ago). Distributing is engaged in the operation of 8 separate lines of business related to the Products industry. These lines of business include Business1, Business2, Business3, Business4, Business5, Business6, Business7, and Business8. Financial documentation has been submitted which indicates that Businesses 1-3 and Businesses 5-8 have had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing is exposed to many types of potential risks and liabilities resulting from Businesses 1-7. Distributing maintains insurance coverage to protect against many, but not all, of its potential risks and liabilities. In order to insure against all of its potential risks and liabilities, Distributing must increase its insurance coverage. However, obtaining insurance policies possessing policy limits that would include the value of the Business8 line of business for certain of the risks would increase Distributing’s premium payments by an additional \$a, and for one risk Distributing cannot purchase coverage with a limit high enough to cover the value of the Business8 line of business.

Expert, Consultant, and Attorney have advised Distributing's management that the risk and liability posed to the Business8 line of business by Distributing's other lines of business can only be reduced by the separation of the Business8 line of business from the other lines of business. Distributing has represented that Distributing cannot protect the Business8 line of business from the risks and liabilities posed by Distributing's other lines of business through an alternative non-taxable transaction which is neither impractical nor unduly expensive.

In order to allow Distributing to protect its Business8 line of business from the risks and liabilities posed by its other lines of business, Distributing has proposed the following transaction:

- (i) Distributing will transfer all of the assets and liabilities constituting the Business8 line of business to a newly formed Controlled in exchange for all of the issued and outstanding stock of Controlled and the assumption by Controlled of the liabilities associated with the Business8 line of business; and
- (ii) Distributing will then distribute all of the issued and outstanding stock of Controlled to the shareholders of Distributing on a pro rata basis.

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

- (a) No part of the consideration to be distributed by Distributing will be received by any person as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (b) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the distribution, Distributing and Controlled each will continue the active conduct of its respective business, independently and with its separate employees.
- (d) The distribution of the stock of Controlled is carried out for the corporate business purpose of risk reduction. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (e) Distributing is not an S corporation (within the meaning of § 1361(a)), but immediately before the distribution, Distributing will be eligible to make an

S corporation election pursuant to § 1362(a). Distributing and Controlled will each elect to be an S corporation pursuant to § 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.

- (f) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the transaction, except for continuing the planned gifting of both voting and non-voting shares by the shareholders to their respective heirs who are also current shareholders.
- (g) 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.
- (h) 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.
- (i) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities to be assumed (as determined under § 357(d)) by Controlled plus any liabilities to which the transferred assets are subject.
- (j) The liabilities to be assumed (as determined under § 357(d)) 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.
- (k) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (m) 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.
- (n) Neither Distributing nor Controlled is an investment company as defined in

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§ 368(a)(2)(F)(iii) and (iv).

- (o) For purposes of section 355(d), immediately after the distribution of Controlled stock, no person (determined by applying section 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 sections 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the distribution of Controlled stock.
- (p) For purposes of section 355(d), immediately after the distribution of Controlled stock, no person (determined after applying section 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 sections 355(d)(5) and (6)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the distribution of Controlled stock or (ii) attributable to distributions on Distributing stock that were acquired by purchase (as defined by sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the distribution of Controlled stock.
- (q) The distribution of Controlled stock is not part of a plan or series of related transactions (within the meaning of § 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 of either Distributing or Controlled entitled to vote, 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 regarding the transaction:

- (1) The transfer by Distributing of the Business8 assets in exchange for Controlled stock and the assumption of related liabilities, followed by the distribution of Controlled stock, will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing on the transfer of assets

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to Controlled in exchange for Controlled stock and the assumption of related liabilities (§§ 357(a), 357(c), and 361(a)).

- (3) No gain or loss will be recognized by Controlled on the receipt of assets from Distributing in exchange for Controlled stock and the assumption of related liabilities (§ 1032(a)).
- (4) The basis of the assets received by Controlled from Distributing will equal the basis of such assets in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (5) The holding period of the assets received by Controlled from Distributing will include the respective periods during which Distributing held such assets (§ 1223(2)).
- (6) No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing on the receipt of the Controlled stock (§ 355(a)(1)).
- (7) No gain or loss will be recognized by Distributing upon the distribution to its shareholders of all of its Controlled stock (§ 361(c)(1)).
- (8) The aggregate basis of the Distributing stock and the Controlled stock held by each of Distributing's shareholders immediately after the distribution of Controlled stock will equal the aggregate basis of each of such shareholder's Distributing stock held immediately before the distribution, allocated in the manner described in Treas. Reg. § 1.358-2 (§ 358(a), (b) and (c); Treas. Reg. § 1.358-1(a)).
- (9) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under Treas. Reg. § 1.312-10(a).
- (10) Distributing's momentary ownership of stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to be an ineligible corporation under § 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under § 1361, Controlled will be eligible to make an S corporation election under § 1362(a) for its first taxable year.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax treatment of the transaction under any other provision of the Code or with respect to the consequences of any aspect of any transaction or item discussed or

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referenced in the rulings contained in this letter. We express no opinion concerning whether Distributing and Controlled will each qualify as an S corporation.

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,

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Thomas I. Russell  
Assistant to the Branch Chief, Branch 5  
Office of Associate Chief Counsel  
(Corporate)

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cc: