

**Internal Revenue Service**

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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Acquiring =

Target 1 =

Target 2 =

Target 3 =

Associates =

Partnership =

State X =

Business A =

Business B =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Dear :

This responds to your December 9, 2003, request for rulings on the federal income tax consequences of a proposed transaction. The information provided in that request and in later correspondence is summarized below.

Acquiring is an State X corporation which is engaged in Business A. Acquiring has outstanding 310 shares of a single class of voting common stock, 121 shares of which are held by Shareholder A and 189 shares of which are held by Associates. Prior to the proposed transaction Acquiring did not have inventories.

Target 1 is an S corporation which, as a general partner in Partnership, is engaged in Business B. Target 1 has outstanding shares of voting common stock and shares of non-voting common stock which are held as follows:

<u>Shareholder</u>	<u>Voting Shares</u>	<u>Non-Voting Shares</u>
Shareholder A		
Shareholder B		
Shareholder C		
Shareholder D		
Shareholder E		

Target 2 is an S corporation which operates as a holding company of an interest in Partnership. The remaining interest in Partnership is held by Target 1. Target 2 has outstanding shares of voting common stock, all of which are held by Shareholder A.

Target 3 is a State X limited liability company which is engaged in Business A. Target 3's units are held as follows: by Shareholder A and by Associates.

Associates is a State X limited partnership. The ownership interests in Associates are held as follows:

<u>General Partners</u>	<u>Limited Partners</u>	<u>Ownership</u>
Shareholder A		percent
Shareholder B		percent
	Shareholder C	percent
	Shareholder D	percent
	Shareholder E	percent

For what are represented to be valid business reasons the following transaction has been proposed:

- (i) Acquiring will split its stock, increasing the outstanding stock from \_\_\_\_\_ shares to \_\_\_\_\_ shares, \_\_\_\_\_ of which will be held by Shareholder A and \_\_\_\_\_ shares of which will be held by Associates
- (ii) Associates will distribute its \_\_\_\_\_ shares of Acquiring to its partners as follows:

<u>Shareholder</u>	<u>Shares</u>
Shareholder A	_____ shares
Shareholder B	_____ shares
Shareholder C	_____ shares
Shareholder D	_____ shares
Shareholder E	_____ shares

- (iii) Acquiring will elect to be taxed as an S corporation pursuant to § 1362 of the Internal Revenue Code.
- (iv) Target 3 will elect classification as an association taxable as a corporation and will issue \_\_\_\_\_ shares of Target 3 stock to Associates and \_\_\_\_\_ shares of Target 3 stock to Shareholder A.
- (v) Associates will distribute the \_\_\_\_\_ shares of Target 3 stock to its partners, pro rata.
- (vi) Target 3 will elect to be taxed as an S corporation pursuant to § 1362.
- (vii) All of the stock in Target 1, Target 2, and Target 3 will be transferred by their shareholders to Acquiring solely in exchange for \_\_\_\_\_ shares of Acquiring voting stock as follows:

<u>Shareholder</u>	<u>Shares for Target 1 Stock</u>	<u>Shares for Target 2 Stock</u>	<u>Shares for Target 3 Stock</u>
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Shareholder A  
Shareholder B  
Shareholder C  
Shareholder D  
Shareholder E

- (viii) Acquiring will elect to treat each of Targets 1, 2 and 3, as a qualified subchapter S subsidiary pursuant to § 1361(b)(3)(B)(ii).
- (ix) Acquiring will distribute \_\_\_\_\_ shares of Acquiring non-voting common stock to its shareholders, pro rata.

In connection with the proposed transfer of all of the outstanding stock of Target 1 to Acquiring as set forth in step (vii) above, followed by the election by Acquiring, as set forth in step (viii) above, and viewing the two steps as constituting a transfer of assets and liabilities by Target 1 to Acquiring in exchange for Acquiring stock, it has been represented that:

- (a) The fair market value of the Acquiring stock received by each Target 1 shareholder will be approximately equal to the fair market value of the Target 1 stock surrendered in the exchange.
- (b) There is no plan or intention by the shareholders of Target 1 to sell, exchange, or otherwise dispose of a number of shares of Acquiring stock received in the transaction that would reduce the Target 1 shareholders' ownership of Acquiring stock to a number of shares having a value, as of the date of the transaction, of less than 50 percent of the value of all of the formerly outstanding stock of Target 1 as of the same date. For purposes of this representation, shares of Target 1 stock exchanged for cash or other property, surrendered by dissenters or exchanged for cash in lieu of fractional shares of Acquiring stock will be treated as outstanding Target 1 stock on the date of the transaction. Moreover, shares of Target 1 stock and shares of Acquiring stock held by Target 1 shareholders and otherwise sold, redeemed, or disposed of prior or subsequent to the transaction will be considered in making this representation.
- (c) Acquiring will acquire at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Target 1 immediately prior to the transaction. For purposes of this representation, amounts paid by Target 1 to dissenters, amounts paid by Target 1 to shareholders who receive cash or other property, amounts

used by Target 1 to pay its reorganization expenses, and all redemptions and distributions (except for regular, normal dividends) made by Target 1 immediately preceding the transfer will be included as assets of Target 1 held immediately prior to the transaction.

- (d) After the transaction, the shareholders of Target 1 will be in control of Acquiring within the meaning of § 368(a)(2)(H) of the Internal Revenue Code.
- (e) Acquiring has no plan or intention to reacquire any of its stock issued in the transaction.
- (f) Acquiring has no plan or intention to sell or otherwise dispose of any of the assets of Target 1 acquired in the transaction, except for dispositions made in the ordinary course of business.
- (g) The liabilities of Target 1 assumed by Acquiring plus the liabilities, if any, to which the transferred assets are subject were incurred by Target 1 in the ordinary course of its business and are associated with the assets transferred.
- (h) Following the transaction, Acquiring will continue the historic business of Target 1 or use a significant portion of Target 1's historic business assets in a business.
- (i) At the time of the transaction, Acquiring will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Acquiring that, if exercised or converted, would affect the Target 1 shareholders' acquisition or retention of control of Acquiring, as defined in § 368(a)(2)(H) of the Code.
- (j) Acquiring, Target 1, and the shareholders of Target 1 will pay their respective expenses, if any, incurred in connection with the transaction.
- (k) There is no intercorporate indebtedness existing between Acquiring and Target 1 that was issued, acquired, or will be settled at a discount,
- (l) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv) of the Code.
- (m) The fair market value of the assets of Target 1 transferred to Acquiring will equal or exceed the sum of the liabilities assumed by Acquiring, plus the amount of liabilities, if any, to which the transferred assets are subject.

- (n) The total adjusted basis of the assets of Target 1 transferred to Acquiring will equal or exceed the sum of the liabilities to be assumed by Acquiring, plus the amount of liabilities, if any, to which the transferred assets are subject.
- (o) Target 1 is not under the Jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A) of the Code.

In connection with the proposed transfer of all of the outstanding stock of Target 2, to Acquiring as set forth in step (vii) above, followed by the election by Acquiring, as set forth in step (viii) above, and viewing the two steps as constituting a transfer of assets and liabilities by Target 2 to Acquiring in exchange for Acquiring stock, it has been represented that:

- (a) The fair market value of the Acquiring stock received by each Target 2 shareholder will be approximately equal to the fair market value of the Target 2 stock surrendered in the exchange.
- (b) There is no plan or intention by the shareholders of Target 2 to sell, exchange, or otherwise dispose of a number of shares of Acquiring stock received in the transaction that would reduce the Target 2 shareholders' ownership of Acquiring stock to a number of shares having a value, as of the date of the transaction, of less than 50 percent of the value of all of the formerly outstanding stock of Target 2 as of the same date. For purposes of this representation, shares of Target 2 stock exchanged for cash or other property, surrendered by dissenters or exchanged for cash in lieu of fractional shares of Acquiring stock will be treated as outstanding Target 2 stock on the date of the transaction. Moreover, shares of Target 2 stock and shares of Acquiring stock held by Target 2 shareholders and otherwise sold, redeemed, or disposed of prior or subsequent to the transaction will be considered in making this representation.
- (c) Acquiring will acquire at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Target 2 immediately prior to the transaction. For purposes of this representation, amounts paid by Target 2 to dissenters, amounts paid by Target 2 to shareholders who receive cash or other property, amounts used by Target 2 to pay its reorganization expenses, and all redemptions and distributions (except for regular, normal dividends) made by Target 2 immediately preceding the transfer will be included as assets of Target 2 held immediately prior to the transaction.
- (d) After the transaction, the shareholders of Target 2 will be in control of Acquiring within the meaning of § 368(a)(2)(H) of the Internal Revenue Code.

- (e) Acquiring has no plan or intention to reacquire any of its stock issued in the transaction.
- (f) Acquiring has no plan or intention to sell or otherwise dispose of any of the assets of Target 2 acquired in the transaction, except for dispositions made in the ordinary course of business.
- (g) The liabilities of Target 2 assumed by Acquiring plus the liabilities, if any, to which the transferred assets are subject were incurred by Target 2 in the ordinary course of its business and are associated with the assets transferred.
- (h) Following the transaction, Acquiring will continue the historic business of Target 2 or use a significant portion of Target 2's historic business assets in a business.
- (i) At the time of the transaction, Acquiring will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Acquiring that, if exercised or converted, would affect the Target 2 shareholders' acquisition or retention of control of Acquiring, as defined in § 368(a)(2)(H) of the Code.
- (j) Acquiring, Target 2, and the shareholders of Target 2 will pay their respective expenses, if any, incurred in connection with the transaction.
- (k) There is no intercorporate indebtedness existing between Acquiring and Target 2 that was issued, acquired, or will be settled at a discount,
- (l) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv) of the Code.
- (m) The fair market value of the assets of Target 2 transferred to Acquiring will equal or exceed the sum of the liabilities assumed by Acquiring, plus the amount of liabilities, if any, to which the transferred assets are subject.
- (n) The total adjusted basis of the assets of Target 2 transferred to Acquiring will equal or exceed the sum of the liabilities to be assumed by Acquiring, plus the amount of liabilities, if any, to which the transferred assets are subject.
- (o) Target 2 is not under the Jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A) of the Code.

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

- (1) Each of the transfers of the outstanding stock of Target 1 and Target 2, followed by the elections to treat such corporations as qualified subchapter S subsidiaries will be viewed, for federal income tax purposes, as a transfer by the respective Target of its assets to Acquiring in exchange for Acquiring stock and the assumption of liabilities (Rev. Rul. 67-274, 1967-2 C.B.141).
- (2) The transfer by Target 1 of substantially all of its assets to Acquiring solely in exchange for Acquiring stock and the assumption by Acquiring of the liabilities of Target 1 will constitute a reorganization within the meaning of § 368(a)(1)(D) of the Code. For the purposes of this ruling, “substantially all” means at least ninety percent of the fair market value of the net assets and at least seventy percent of the fair market value of the gross assets of Target 1. Target 1 and Acquiring will each be a party to a reorganization within the meaning of § 368(b) of the Code.
- (3) No gain or loss will be recognized to Target 1 upon the transfer of its property solely in exchange for Acquiring stock and the assumption by Acquiring of the liabilities of Target 1 (§§ 361(a) and 357(a)).
- (4) No gain or loss will be recognized to Acquiring upon the receipt of the assets of Target 1 in exchange for Acquiring stock (§ 1032(a)).
- (5) No gain or loss will be recognized to the Target 1 shareholders upon the exchange of the stock in Target 1 solely for Acquiring stock (§ 354(a)(1)).
- (6) The basis of the stock of Acquiring received in exchange for Target 1 stock in the transaction will be the same as the basis of the Target 1 stock surrendered in exchange therefor (§ 358(a)(1)).
- (7) The holding period of the Acquiring stock received in exchange for Target 1 stock will include the period during which the stock surrendered in exchange therefor was held, provided such stock constituted a capital asset on the date of the exchange (§ 1223(1)).
- (8) As provided in § 381(a), Acquiring will succeed to and take into account the items of Target 1 described in § 381(c), subject to the provisions and limitations of §§ 381, 382, 383, and 384.
- (9) The transfer by Target 2 of substantially all of its assets to Acquiring solely in exchange for Acquiring stock and the assumption by Acquiring of the liabilities of Target 2 will constitute a reorganization within the meaning of



§ 368(a)(1)(D) of the Code. For the purposes of this ruling, “substantially all” means at least ninety percent of the fair market value of the net assets and at least seventy percent of the fair market value of the gross assets of Target 2. Target 2 and Acquiring will each be a party to a reorganization within the meaning of § 368(b) of the Code.

- (10) No gain or loss will be recognized to Target 2 upon the transfer of its property solely in exchange for Acquiring stock and the assumption by Acquiring of the liabilities of Target 2 (§§ 361(a) and 357(a)).
- (11) No gain or loss will be recognized to Acquiring upon the receipt of the assets of Target 2 in exchange for Acquiring stock (§ 1032(a)).
- (12) No gain or loss will be recognized to the Target 2 shareholders upon the exchange of the stock in Target 2 solely for Acquiring stock (§ 354(a)(1)).
- (13) The basis of the stock of Acquiring received in exchange for Target 2 stock in the transaction will be the same as the basis of the Target 2 stock surrendered in exchange therefor (§ 358(a)(1)).
- (14) The holding period of the Acquiring stock received in exchange for Target 2 stock will include the period during which the stock surrendered in exchange therefor was held, provided such stock constituted a capital asset on the date of the exchange (§ 1223(1)).
- (15) As provided in § 381(a), Acquiring will succeed to and take into account the items of Target 2 described in § 381(c), subject to the provisions and limitations of §§ 381, 382, 383, and 384.
- (16) Section 1363(d) will not require Partnership or Acquiring to include in their gross income any LIFO recapture amount for the inventory deemed transferred to Acquiring.

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 taxpayers 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,

*Debra Carlisle*

Debra Carlisle  
Chief, Branch 5  
Office of Associate Chief Counsel  
(Corporate)

cc: