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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:B06-PLR-136357-03
Date:
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LEGEND:

Distributing =

Controlled =

Business A =

military bases and other multi-housing locations

Business B =

Date 1 =

Date 2 =

State A =

Hazard E =

Dear

This letter is in response to your authorized representative's letter dated June 10, 2003, requesting rulings on certain federal income tax consequences of a proposed transaction. Additional information was received in a letter dated July 29, 2003. The material information submitted is summarized below.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalties of perjury

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statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for a ruling. Verification of the information, representations, and other data may be required as part of the audit process.

SUMMARY OF FACTS

Distributing is a domestic corporation that was incorporated as a subchapter C corporation on Date 1 in State A. On Date 2, Distributing made a subchapter S election. Distributing has one class of common stock issued and outstanding. Distributing engages in Business A and in Business B.

Controlled will be a corporation that is formed under the laws of State A for the purpose of independently operating Business B. Controlled will have outstanding one class of common stock. All of the stock in Controlled initially will be held by Distributing.

Financial information has been received for both Business A and Business B indicating that each business of Distributing has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing has demonstrated that the nature of Business A exposes Business B to liabilities and litigation arising from Hazard E. To allow Business B to be completely segregated and insulated from the risks associated with Hazard E, Distributing has proposed the following transaction:

- (i) Distributing will form Controlled.
- (ii) Distributing will contribute to Controlled the assets of Business B in exchange for 100 percent of the outstanding stock of Controlled and the assumption by Controlled of the liabilities relating to Business B.
- (iii) Distributing will distribute the shares of Controlled to its shareholders pro-rata (the "Distribution").
- (iv) Controlled will elect to be taxed as an S corporation on the first available date after the Distribution. Distributing will retain its subchapter S election.

REPRESENTATIONS

Distributing has made the following representations regarding the proposed transaction:

- (a) 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 the corporation.

- (b) 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.
- (c) Immediately after the Distribution, the gross assets of the active business conducted by Distributing (as defined in section 355(b)(2) of the Internal Revenue Code ("the Code")) will have a fair market value that is at least 5 percent of the total fair market value of the gross assets of Distributing.
- (d) Immediately after the Distribution, the gross assets of the active business conducted by Controlled (as defined in section 355(b)(2)) will have a fair market value that is at least 5 percent of the total fair market value of the gross assets of Controlled.
- (e) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (f) The Distribution will be carried out for the following corporate purpose: to significantly enhance the protection of Business B from the risks of Business A. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (g) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing or Controlled after the Distribution, except for transfers by gifts to family members.
- (h) 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 Distribution.
- (i) 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 Distribution, except in the ordinary course of business.
- (j) Distributing is an S corporation (within the meaning of section 1361(a)). Controlled will elect to be an S corporation pursuant to section 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.

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- (k) 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 by Controlled plus any liabilities to which the transferred assets are subject.
- (l) The liabilities assumed by Controlled in the Distribution 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) No investment tax credit under the Code has been, or will be, claimed with respect to any of the assets of Business B being transferred by Distributing to Controlled.
- (n) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (o) 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.
- (p) No two parties to the Distribution are investment companies as defined in sections 368(a)(2)(F)(iii) and (iv).
- (q) Distributing, Controlled and Distributing's shareholders will each pay their own expenses, if any, incurred in connection with the Distribution.
- (r) The cash and investment assets held by Distributing and to be held by Controlled are related to the reasonable needs of the conduct of the active trade or business of each corporation.
- (s) 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 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.
- (t) Immediately after the Distribution, no person will hold "disqualified stock" in Distributing or Controlled which constitutes a 50 percent or greater interest in such corporations within the meaning of section 355(d).

RULINGS

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

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- (1) The transfer by Distributing of the assets of Business B to Controlled solely in exchange for common stock of Controlled and the assumption of related liabilities, followed by the Distribution, will constitute a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled will each be “a party to a reorganization” within the meaning of section 368(b).
- (2) No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for common stock of Controlled and the assumption of related liabilities. Sections 361(a), 357(a), and 357(c).
- (3) No gain or loss will be recognized by Controlled upon the receipt of the assets from Distributing in exchange for common stock of Controlled and the assumption of related liabilities. Section 1032(a).
- (4) The basis of the assets to be received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the Distribution. Section 362(b).
- (5) The holding period of the Distributing assets to be 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 by Distributing upon the Distribution. Section 361(c)(1).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) Distributing’s shareholders upon the receipt of the stock of Controlled. Section 355(a)(1).
- (8) The aggregate basis of the stock of Controlled and Distributing in the hands of the Distributing shareholders after the Distribution will be the same as the aggregate basis of the Distributing stock in the hands of the Distributing shareholders immediately prior to the Distribution, allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each corporation’s stock in accordance with section 1.358-2(a)(2) of the Income Tax Regulations. Sections 358(a)(1), (b) and (c).
- (9) The holding period of the stock of Controlled to be received by the shareholders will include the holding period of Distributing’s stock, provided that the shares of Distributing stock were held as a capital asset on the date of the Distribution. Section 1223(1).
- (10) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under section 1.312-10(a) of the Income Tax Regulations.

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- (11) Distributing's accumulated adjustments account immediately before the Distribution 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) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under section 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under section 1361, Controlled will be eligible to make a subchapter S election under section 1362(a) for its first taxable year.

CAVEATS

No opinion is expressed about the tax treatment of the transaction under any other provision of the Code or Regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed concerning the tax consequences associated with whether:

- (a) Distributing's S election is valid;
- (b) Controlled is otherwise eligible to elect to be taxed as an S corporation; or
- (c) Controlled's election will be valid under section 1362(a).

PROCEDURAL STATEMENTS

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to the federal income tax return of each taxpayer involved for the taxable year in which the transaction is consummated.

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

Sincerely yours,

Alfred C. Bishop, Jr.

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