Internal Revenue Service

Number: **201119017**
Release Date: 5/13/2011

Index Number: 1361.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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PLR-139002-10

Date:
February 07, 2011

X =

Y =

State =

Date 1 =

Date 2 =

n1 =

n2 =

n3 =

Dear :

This responds to a letter dated September 14, 2010, and subsequent correspondence, submitted on behalf of X, requesting rulings under §§ 1361 and 368 of the Internal Revenue Code.

FACTS

The information submitted states that X was incorporated under the laws of State on Date 1 and made an election to be treated as an S corporation effective Date 2. X has determined that it is desirable to operate in a holding company structure to provide additional liability protections, add certain restrictions on transfers, and obtain state tax savings that are independent of and not related to federal income taxes.

To achieve this objective, X plans to undertake a transaction through the following steps. First, Y will be formed under the laws of State as a limited liability partnership. Y's partnership agreement will provide for n1 voting units and n2 nonvoting units. The voting and nonvoting units will confer identical rights with respect to limited liability in addition to identical distribution and liquidation rights. Y will file an election under § 301.7701-3 to be classified as an association taxable as a corporation for federal tax purposes.

Second, the shareholders of X will contribute all of their X stock to Y in exchange for all of Y's units. Each of X's shareholders will receive Y units in proportion to the voting and nonvoting X stock owned by such shareholder. The owners of Y will be persons who qualify as eligible shareholders under § 1361.

Third, Y will elect to treat X as a qualified subchapter S subsidiary (QSub) by filing a Form 8869, Qualified Subchapter S Subsidiary Election, within two months and fifteen days after acquiring all of X's stock.

After the transaction, X intends to retain its federal employer identification number for payroll tax and other reporting requirements in which X is treated as a separate corporation for federal tax purposes. Y will obtain a new federal identification number.

We have been asked to rule that (1) the restructuring will be treated as a reorganization under § 368(a)(1)(F), (2) Y's partnership agreement does not create a second class of stock, (3) X's original S corporation election does not terminate but continues for Y, (4) X will retain its federal employer identification number (EIN) for payroll tax and other similar reporting requirements in which it is treated as a separate corporation for federal tax purposes, and (5) Y should obtain and use a new EIN.

REPRESENTATIONS

X has made the following representations in connection with the proposed transaction:

(1) The fair market value of the Y stock and other consideration received by each X shareholder will be approximately equal to the fair market value of the X stock surrendered in the exchange.

(2) There is no plan or intention by the shareholders of X who own 1 percent or more of the X stock, and to the best of the knowledge of management of X, there is no plan or intention on the part of the remaining shareholders of X to sell, exchange or otherwise dispose of any of the shares of Y stock received in the transaction. Shareholders who own 1 percent or more of the X stock are

considering the possibility of both making gifts to family members and making gifts and/or sales to trusts which would be grantor trusts with respect to the donor/seller under § 671 et seq. There is no binding obligation or plan to make any such gifts or sales.
(3) Immediately following consummation of the transaction, the shareholders of X will own all of the outstanding Y stock and will own such stock solely by reason of their ownership of X stock immediately prior to the transaction.
(4) Y has no plan or intention to issue additional shares of its stock following the transaction.
(5) Dissenting shareholders, if any, will own less than one percent of the X stock.
(6) At the time of the transaction, X will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in X. Shareholders of X have granted rights of first refusal and similar options intended to prevent transfers to shareholders not eligible to own S corporation stock and to prevent transfers outside the family which presently owns n3 of the stock of X. Similar restrictions will apply with respect to interests in Y. None of these rights or options are currently exercisable nor expected to become exercisable in the foreseeable future. Neither X nor Y has itself granted warrants or options to issue new stock or Y interests nor is there any intention to do so.
(7) Y has no plan or intention to reacquire any of its stock issued in the transaction.
(8) Y has no plan or intention to sell or otherwise dispose of any of the assets of X acquired in the transaction, except for dispositions made in the ordinary course of business.
(9) The liabilities of X assumed by Y plus the liabilities, if any, to which the transferred assets are subject were incurred by X in the ordinary course of its business and are associated with the assets deemed to be transferred.
(10) Following the transaction, Y will continue the historic business of X or use a significant portion of X's historic business assets in a business.
(11) The shareholders, X, and Y will pay their respective expenses, if any, incurred in connection with the transaction.
(12) X is not presently, and Y will not be immediately after the transaction, under the jurisdiction of a court in a title 11 or similar case within the meaning of section 368(a)(3)(A) of the Code.

LAW AND ANALYSIS

Section 368(a)(1)(F) provides that a reorganization includes a mere change in identity, form, or place of organization of one corporation, however effected.

Section 1361(a) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(b)(3)(A) provides that, except as provided in the regulations, a qualified subchapter S subsidiary (QSub) shall not be treated as a separate corporation and all assets, liabilities, and items of income, deduction, and credit of the QSub shall be treated as assets, liabilities and such items of the S corporation. Section 1361(b)(3)(B) provides that a QSub means any domestic corporation which is not an ineligible corporation, if 100 percent of the stock of the QSub is held by the S corporation and the S corporation elects to treat the corporation as a QSub.

Section 1.1361-4(a)(2) provides that, if an S corporation makes a valid QSub election with respect to a subsidiary, the subsidiary is deemed to have liquidated into the S corporation and that, except as provided in § 1.1361-4(a)(5), the tax treatment of the liquidation of a larger transaction that includes the liquidation is determined under the Code and general principles of tax law, including the step transaction doctrine.

Rev. Rul. 64-250, 1964-2 C.B. 333, provides that when an S corporation merges into a newly formed corporation in a transaction qualifying as a reorganization under § 368(a)(1)(F), and the newly formed surviving corporation also meets the requirements of an S corporation, the reorganization does not terminate the S election. Thus, the S election remains in effect for the new corporation. See also Rev. Rul. 2004-85, 2004-2 C.B. 189.

Rev. Proc. 86-42, 1986-2 C.B. 722, sets forth certain standard representations that must be submitted as a prerequisite to the issuance of rulings on the tax consequences of certain transactions under § 368(a). Section 3.07 lists the representations that must be submitted by a taxpayer that receives a ruling that a transaction will be treated as a reorganization under § 368(a)(1)(F).

In Rev. Rul. 2008-18 (Situation 1), B, an individual, owned all of the stock of Y, an S corporation. In Year 1, B formed Newco and contributed all of the Y stock to Newco. Newco met the requirements for qualification as a small business corporation and timely elected to treat Y as a qualified subchapter S subsidiary (QSub), effective immediately following the transaction. The transaction met the requirements of a reorganization under section 368(a)(1)(F).

RULINGS

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

(1) The contribution of X stock to Y followed by the election to treat X as a QSub is a reorganization within the meaning of § 368(a)(1)(F). X and Y will each be a "party to a reorganization" within the meaning of § 368(b).

(2) No gain or loss will be recognized by X upon the deemed transfer of assets to Y in exchange for Y stock and Y's assumption of liabilities (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Y on the deemed receipt of X assets in exchange for Y stock as described above (§ 1032(a)).

(4) The basis of each asset deemed received by Y will be the same as the basis of such asset in the hands of X immediately prior to the transaction (§ 362(b)).

(5) The holding period for each of the assets deemed received by Y will include the period during which such asset was held by X (§ 1223(2)).

(6) No gain or loss will be recognized by X upon the distribution to its shareholders of the Y stock (§ 361(c)(1)).

(7) No gain or loss will be recognized by the X shareholders upon receipt of Y stock in exchange for their X stock (§ 354(a)(1)).

(8) The basis of the Y stock received by the X shareholders will be equal to the basis of the X stock surrendered in exchange therefor (§ 358(a)(1) of the Code and § 1.358-2 of the Income Tax Regulations).

(9) The holding period of the Y stock received by the X shareholders will include the period during which the shareholders held the X stock exchanged therefor, provided that the X stock is held as a capital asset in the hands of the shareholders on the date of the exchange (§ 1223(1)).

(10) The transaction does not result in a closing of the tax year (§ 381(b) of the Code and § 1.381(b)-1(a)(2) of the Income Tax Regulations).

(11) As provided by § 381(a), Y will succeed to and take into account, as of the date the transaction is consummated, all the items of X described in § 381(c), including any X earnings and profits or any deficit therein.

(12) After the transaction is completed, X's original S corporation election does not terminate but continues for Y.

(13) Y's partnership agreement will not create a second class of stock.

(14) After the transaction is completed, X will retain its federal employer identification number (EIN) for payroll tax and other similar reporting requirements in which it is treated as a separate corporation for federal tax purposes.

(15) Y must obtain a new EIN.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal income tax consequences of the facts described above under any other provision of the Code, including whether X is otherwise a valid S corporation prior to the transaction, Y's eligibility to be an S corporation, or X's eligibility to be a QSub after the transaction.

In accordance with the power of attorney on file with this office, copies of this letter ruling will be sent to the taxpayer's representatives.

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.

Sincerely,

Richard T. Probst
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes