

## Internal Revenue Service

Department of the Treasury  
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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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Date:

February 27, 2012

### Legend

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

b =

Business Line A =

Business Line B =

Year 1 =

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to your November 23, 2011 request for rulings as to the federal income tax consequences of a proposed transaction. The information received in that request and in subsequent correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the Distribution (defined below): (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) of the Internal Revenue Code and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7).

### **Summary of Facts**

Distributing is a domestic corporation that employs a cash method of accounting and maintains a calendar year for tax and accounting purposes. It has a single class of stock outstanding of which Shareholder A and Shareholder B own 100 percent. Distributing is engaged in Business Line A.

In Year 1, Distributing began operating Business Line B in the course of conducting Business Line A. On Date 1, Distributing incorporated Controlled; on Date 2, Distributing transferred thereto all of the assets and liabilities related to Business Line B. Controlled employs a cash method of accounting and maintains a calendar year for tax and accounting purposes. Controlled has a single class of stock outstanding, of which Distributing owns b percent (more than 80 percent). Shareholder C and Shareholder D own the remainder. Distributing and Controlled file separate Federal tax returns. Distributing has submitted financials showing gross receipts and operating expenses

reflecting its active conduct of Business Line A for each of the past five years and for the active conduct of Business Line B since Year 1.

Distributing proposes to distribute all of its stock in Controlled to Distributing's shareholders *pro rata* (hereinafter, "the Distribution"), in no event sooner than Date 3. The Distribution will allow Distributing to issue equity to certain key employees without providing an indirect interest in Controlled, and the Distribution will facilitate future third-party investments in Distributing and Controlled, respectively.

### **Representations**

Distributing represents as follows:

- 1) No part of the consideration to be distributed by Distributing in the Distribution will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- 2) Each of the parties to the Distribution will pay its own expenses incurred in connection with the Distribution.
- 3) The five years of financial information submitted on behalf of Business Line A is representative of the present business operations of Business Line A, and, with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- 4) The five years of financial information submitted on behalf of Business Line B is representative of the present business operations of Business Line B conducted by Controlled, and, with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- 5) Neither Business Line A nor control of an entity conducting this business was acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized under proposed Treas. Reg. § 1.355-3) in whole or in part. Throughout the five-year period ending on the date of the Distribution, Distributing has been the principal owner of the goodwill and significant assets of Business Line A. Distributing will be the principal owner of the goodwill and significant assets of Business Line A following the Distribution.
- 6) Neither Business Line B nor control of an entity conducting this business was acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized under proposed Treas. Reg. § 1.355-3) in whole or in part. Throughout the five-year period ending on the date of the Distribution, Distributing and Controlled have been the principal owners of the goodwill and significant assets of Business Line

B. Controlled will be the principal owner of the goodwill and significant assets of Business Line B following the Distribution.

- 7) Following the Distribution, Distributing will continue the active conduct of Business Line A, independently and with its separate employees.
- 8) Following the Distribution, Controlled will continue the active conduct of Business Line B, independently and with its separate employees.
- 9) The Distribution is not being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- 10) The Distribution is being carried out (i) to enable Distributing to issue equity to certain key employees without providing such employees an indirect interest in Controlled and (ii) to facilitate future third-party investments in Distributing and Controlled. The Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- 11) No intercorporate indebtedness will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- 12) There are no continuing, planned, or intended transactions between Distributing and Controlled following the proposed transactions, either directly or indirectly.
- 13) 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.
- 14) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of 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.
- 15) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of 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 (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on 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.

- 16) The Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of section 355(d)(4)) in either Distributing or Controlled (including any predecessor or successor of Distributing or Controlled).
- 17) Immediately after the transaction (taking into account section 355(g)(4)), either (i) no person will hold a 50-percent or greater interest (within the meaning of section 355(g)) in the stock of Distributing or Controlled, who did not hold such an interest immediately before the Distribution, or (ii) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of section 355(g)(2)).

### **Rulings**

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

- 1) No gain or loss will be recognized by (and no amount otherwise will be included in the income of) the shareholders of Distributing on their receipt of Controlled shares in the Distribution (section 355(a)(1)).
- 2) No gain or loss will be recognized by Distributing as a result of the Distribution (section 355(c)(1)).
- 3) The aggregate basis of the Distributing shares and the Controlled shares in the hands of the shareholders of Distributing after the Distribution will be the same as the basis of the Distributing shares in the hands of the shareholders of Distributing immediately before the Distribution (section 358(a) and Treas. Reg. § 1.358-1(a)). Such basis will be allocated between the Distributing shares and the Controlled shares in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a)(2) (sections 358(b)(2) and 358(c)).
- 4) The holding period of the Controlled shares received by the shareholders of Distributing in the Distribution will include the holding period of the Distributing shares with respect to which the Distribution will be made, provided that such Distributing shares are held as capital assets on the date of the Distribution (section 1223(1)).
- 5) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under Treas. Reg. § 1.312-10(b).

**Caveats**

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. In particular, no opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Distribution is being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled, or both (see section 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Distribution is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest in Distributing or Controlled (see section 355(e) and § 1.355-7).

**Procedural Statements**

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. A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

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Joanne M. Fay  
Assistant Branch Chief, Branch 3  
(Corporate)

cc: