

**Internal Revenue Service**

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:CORP:2-PLR-106805-00  
Date:  
October 27, 2000

**LEGEND:**

- Target 1 =
- Target 2 =
  
- State A =
- State B =
  
- Business =
  
- y =
- z =
  
- Year 1 =
- Year 2 =
  
- Date 1 =

Dear:

This letter responds to your authorized representative's letter dated March 21, 2000, in which rulings were requested as to certain federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated June 28, October 12 and October 25, 2000.

The information submitted indicates that Target 1 was incorporated in Year 1 as a State A corporation. Target 1 is engaged in Business and is a calendar year taxpayer using the accrual method of accounting. On Date 1, Target 1 made an election in accordance with the provisions of § 1362 of the Internal Revenue Code to be taxable as a Subchapter S corporation. Target 1 is no longer subject to the recognition period for certain built-in gains provided under § 1374.

Target 2 was incorporated in Year 2 as a State B corporation. Since its inception, Target 2 has been taxable as a Subchapter S corporation. Target 2 is engaged in Business and is a calendar year taxpayer using the accrual method of accounting.

Target 1 and Target 2 are each closely held, and there is significant overlap in their shareholders. Target 1 and Target 2 each has outstanding two classes of voting common stock, consisting of  $y$  shares of Class A voting common and  $z$  shares of Class B voting common. The only difference between the two classes of stock is with respect to voting rights: the holders of the Class A common elect three members of the board of directors, while holders of the Class B common elect two members of the board.

For valid business reasons the following transaction is proposed:

- (i) The shareholders of Target 1 and Target 2 will incorporate Newco as a State A corporation. Newco will elect S corporation status in accordance with the provisions of § 1362, to be effective for its first taxable year. Newco will have two classes of authorized stock, Class A voting common and Class B voting common. Class A and Class B voting common will have identical rights to distribution and liquidation proceeds and differ only as to voting rights. § 1.1361-1(l)(1).
- (ii) Immediately after the incorporation of Newco described above, the shareholders of Target 1 and Target 2 will contribute all of their respective stock in Target 1 and Target 2 to Newco in exchange for stock of Newco. As a result, Target 1 and Target 2 will become wholly owned subsidiaries of Newco.
- (iii) Newco will elect to treat Target 1 and Target 2 as qualified Subchapter S subsidiaries (the "QSub elections") as defined in § 1361(b)(3)(B), in accordance with the procedures set forth in § 1.1361-3 of the Income Tax Regulations.

The following representations with respect to the proposed transaction have been submitted under penalties of perjury:

(a) To the best of taxpayer's knowledge and belief, the transfer to Newco by the Target 1 and Target 2 shareholders of all of their respective stock in Target 1 and Target 2, solely in exchange for shares of stock in Newco, will qualify under § 351 of the Code.

(b) On the date of adoption of the plan of liquidation and at all times until the final liquidating distribution is completed, Newco will be the owner of 100 percent of the total combined voting power of all classes of stock of Target 1 entitled to vote and the owner of 100 percent of the total value of all classes of stock.

(c) On the date of adoption of the plan of liquidation and at all times until the final liquidating distribution is completed, Newco will be the owner of 100 percent of the total combined voting power of all classes of stock of Target 2 entitled to vote and the owner of 100 percent of the total value of all classes of stock.

(d) No shares of Target 1 stock will have been redeemed during the three years preceding Newco's QSub election for Target 1.

(e) No shares of Target 2 stock will have been redeemed during the three years preceding Newco's QSub election for Target 2.

(f) Target 1 will not have acquired assets in any nontaxable transaction at any time, except for acquisitions occurring more than three years prior to the date that Newco makes the QSub election for Target 1.

(g) Target 2 will not have acquired assets in any nontaxable transaction at any time, except for acquisitions occurring more than three years prior to the date that Newco makes the QSub election for Target 2.

(h) No assets of Target 1 have been, or will be, disposed of by Target 1 or Newco except for dispositions in the ordinary course of business and dispositions occurring more than three years prior to Newco's QSub election for Target 1.

(i) No assets of Target 2 have been, or will be, disposed of by Target 2 or Newco except for dispositions in the ordinary course of business and dispositions occurring more than three years prior to Newco's QSub election for Target 2.

(j) The deemed liquidation of Target 1 will not be preceded by, nor will it be followed by, the reincorporation in, or transfer or sale to, a recipient corporation of any of the businesses or assets of Target 1, if persons holding, directly or indirectly, more than 20 percent in value of the Target 1 stock also hold, directly or indirectly, more than 20 percent in value of the stock in Target 1 recipient. For purposes of this representation, ownership is determined by application of the constructive ownership rules of § 318(a) as modified by § 304(c)(3).

(k) The deemed liquidation of Target 2 will not be preceded by, nor will it be followed by, the reincorporation in, or transfer or sale to, a recipient corporation of any of the businesses or assets of Target 2, if persons holding, directly or indirectly, more than 20 percent in value of the Target 2 stock also hold, directly or indirectly, more than 20 percent in value of the stock in Target 2 recipient. For purposes of this representation, ownership is determined by application of the constructive ownership rules of § 318(a) as modified by § 304(c)(3).

(l) Prior to making the QSub election with respect to Target 1, no assets of Target 1 will have been distributed in kind, transferred, or sold to Newco, except for (i) transactions occurring in the normal course of business and (ii) transactions occurring more than three years prior to making the QSub election with respect to Target 1.

(m) Prior to making the QSub election with respect to Target 2, no assets of Target 2 will have been distributed in kind, transferred, or sold to Newco, except for (i) transactions occurring in the normal course of business and (ii) transactions occurring more than three years prior to making the QSub election with respect to Target 2.

(n) The fair market value of the assets of Target 1 will exceed its liabilities both at the date the Qsub election is made and immediately prior to the time the deemed liquidation of Target 1 takes place.

(o) The fair market value of the assets of Target 2 will exceed its liabilities both at the date the Qsub election is made and immediately prior to the time the deemed liquidation of Target 2 takes place.

(p) There is no intercorporate debt existing between Newco and Target 1, and none has been canceled, forgiven, or discounted.

(q) There is no intercorporate debt existing between Newco and Target 2, and none has been canceled, forgiven, or discounted.

(r) Newco is not an organization that is exempt from federal income tax under § 501 or any other provision of the Code.

The representations submitted form a material basis for the issuance of our rulings. Based solely on the information submitted and representations, we rule as follows:

(1) Provided the QSub elections for Target 1 and Target 2 are effective as of the date the stock of Target 1 and Target 2 is acquired by Newco and before January 1, 2001, Target 1 and Target 2 will each be treated as though it liquidated into Newco at the beginning of the day the termination of the S elections of Target 1 and Target 2 are effective in transactions described in §§ 332 and 337 (§§ 1.1361-4(a)(2), (a)(5), and (b)(3)(ii)).

(2) No gain or loss will be recognized by Newco in connection with the QSub elections for Target 1 and Target 2 (§ 332(a)).

(3) No gain or loss will be recognized by Target 1 or Target 2 in connection with the QSub elections (§ 337(a)).

(4) For federal income tax purposes, Target 1 and Target 2 will not be treated as separate corporations, and all assets, liabilities, and items of income, deduction, and credit of Target 1 and Target 2 will be treated as assets, liabilities, and such items (as the case may be) of Newco as of the effective date of the respective QSub election (§ 1361(b)(3)(A), § 1.1361-4(a)(1)).

(5) Newco will succeed to and take into account those attributes of Target 1 and Target 2 described in § 381(c), subject to the provisions and limitations specified in §§ 381, 382, 383, and 384, if applicable, and the regulations thereunder (§ 381(a) and § 1.381(a)-(1)).

(6) Newco will succeed to and take into account the Subchapter C earnings and profits (or deficit in earnings and profits) and the Accumulated Adjustments Account of Target 1 and Target 2, if any, as of the dates of the respective QSub elections (§§ 381(c)(2), § 1.381(c)(2)-1, and § 1.1368-2(d)(2)).

No opinion is expressed about the tax treatment of the proposed transactions under other provisions of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not

directly covered by the above rulings. In particular, no opinion is expressed under § 351 or on whether Newco is otherwise eligible to be an S corporation or Target 1 and Target 2 are otherwise eligible to be QSubs.

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

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this ruling

letter are consummated.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to the taxpayer's authorized representative.

Sincerely,  
Associate Chief Counsel (Corporate)  
By: Edward S. Cohen  
Chief, Branch 2