

Internal Revenue Service

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Person To Contact:

Telephone Number:

Refer Reply To:

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Date:

September 30, 2003

Oldco =

A =

B =

C =

D =

E =

F =

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G =

H =

a =b =

State X =

Date 1 =

Date 2 =

Activity A =

Dear

We respond to your request dated December 4, 2002, for rulings on the federal income tax consequences of a proposed transaction. You submitted additional information in letters dated March 12, 2003, April 10, 2003, and June 16, 2003. The information submitted for consideration is summarized below.

Oldco, a State X corporation, was incorporated on Date 1 and elected to be treated as a subchapter S corporation (within the meaning of § 1361 of the Internal Revenue Code) effective Date 2. Oldco has no accumulated earnings and profits from its period as a subchapter C corporation and has no assets that are subject to § 1374. Oldco is owned as follows: A and B each own a percent while C, D, E, F, G, and H each own b percent.

Oldco is engaged in Activity A and believes that it could better serve the community if it were organized and operated as a nonprofit, tax-exempt organization. As a nonprofit organization, Oldco would be able to expand its present programs and reach more people.

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Accordingly, the following transactions have been proposed:

- (i) The shareholders of Oldco will form a new nonprofit State X corporation (“Newco”). Taxpayer represents that Newco will apply to be recognized as a tax-exempt entity under § 501(c)(3) and that it will be recognized as such as of the time of the Merger, defined below.
- (ii) Oldco will merge into Newco under State X law, and Newco will be the surviving corporation (the “Merger”). In the Merger, Newco will acquire all of the assets and assume all of the liabilities of Oldco. Neither Oldco nor its shareholders will receive any consideration or any other kind of benefit in the Merger. Newco will not issue any membership interests. Taxpayer represents that the Merger will not qualify as a tax-free reorganization under § 368(a) and that the fair market value of Oldco’s assets will exceed its liabilities at the time of the Merger.

After the Merger, Newco will continue and expand Activity A. The shareholders of Oldco will not be employed by or do business with Newco.

Based solely on the information submitted and representations made, we hold as follows:

1. Upon transfer of Oldco’s items of property to Newco, Oldco will be treated as selling its items of property for an amount realized equal to the amount of liabilities transferred. Then, if, under § 1011(b), a deduction is allowable under § 170 by reason of a sale, the adjusted basis for determining the gain from such sale, if any, shall be that portion of the adjusted basis which bears the same ratio to the adjusted basis as the amount realized bears to the fair market value of that item of property (§§ 1011(b), 1.1001-2(a) and 1.1011-2(a)(3)).
2. To the extent gains and losses otherwise are not recognized by Oldco on the sale of its items of property described in Ruling 1, above (i.e., on the part of its items of property in excess of the amount of liabilities transferred), Oldco will recognize gains and losses immediately before the Merger as if the assets transferred actually were sold at their fair market values (§§ 337(d) and 1.337(d)-4).
3. The character of the gains and losses in Ruling 2, above, will be the same as if the assets transferred were sold at their fair market values.

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4. The gains and losses recognized on the sale of the items of property, in Ruling 1, above, or on the deemed transfer of assets in Ruling 2, above, will not be taxable to Oldco; rather, under §§ 1366(a)(1) and 1.1366-1(a)(2), each shareholder must take into account separately his or her distributive share of any gains and losses recognized by Oldco as a result of either the sale of property or deemed transfer of assets as described above. In addition, at the close of Oldco's taxable year, each shareholder will make appropriate adjustments to stock basis under § 1367(a), and to the extent appropriate, basis in indebtedness under § 1367(b), for his or her distributive share of gains and losses for the year.
5. Assuming that Newco is recognized as tax-exempt under § 501(c)(3), we conclude that since gains and losses are realized and recognized under §§ 1001 and 337(d) in the same taxable year in which the contribution, if any, is made (see Rulings 1 and 2 above), § 170(e)(1) does not apply to the transaction. If Oldco is entitled to a charitable contribution under § 170, it is only to the extent that all the other requirements of § 170 are met.
6. Under § 1366(a)(1), each shareholder will take into account his or her distributive share of Oldco's charitable contributions, subject to the limitation of § 1366(d)(1). Each shareholder will include his or her distributive share of charitable contributions in making adjustments under § 1367 for his or her taxable year. Because Oldco is an S corporation, the § 170(b)(2) limitations are inapplicable and the limitations of § 170(b)(1) will apply to the shareholders individually.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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. Specifically, no opinion is expressed concerning any of the other tax consequences arising from the Merger. Finally, the rulings in this letter have no effect if Newco is not recognized as having tax-exempt status under § 501(c)(3) as of the time of the Merger.

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

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

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Filiz A. Serbes
Filiz A. Serbes
Chief, Branch 3
Office of Associate Chief Counsel
(Corporate)