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June 15, 2000

Re:

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Business A =

State A =

Dear :

This letter responds to a letter dated February 10, 2000, requesting a ruling as to the federal income tax consequences of a proposed transaction. The information submitted in that letter and subsequent correspondence is summarized below.

Distributing, a State A corporation that uses the accrual method and a fiscal year ending August 31, has for many years been engaged in Business A. Distributing has outstanding a single class of voting common stock held half-and-half by Shareholders A and B.

Controlled is a corporation formed under the laws of State A. It will use the accrual method and a fiscal year ending August 31. Controlled will have outstanding solely voting common stock, all of which will initially be held by Distributing.

The financial information received indicates that Business A has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past 5 years.

Shareholders A and B disagree as to the desirability of investing in new and improved equipment and expanding into new markets. Disagreements over these and other issues have brought short and long range planning to a halt. In order to free Distributing from the problems caused by these shareholder disputes, it is desired for Distributing's Business A to be divided between Shareholders A and B. Accordingly, the following steps are proposed:

- (I) Distributing will transfer about half of most kinds of operating assets to Controlled in exchange for all the outstanding stock in Controlled. Then, Controlled and Distributing will each be able to conduct Business A. Most accounts payable will remain with Distributing. To equalize the values of Distributing and Controlled, Distributing will retain a larger portion of cash and accounts receivable.
- (II) Thereafter, Shareholder A will exchange all his stock in Distributing for all the outstanding stock in Controlled.

The following representations have been made in connection with the transactions:

- (a) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing will equal or exceed the sum of the liabilities assumed (as determined under § 357(d)) by Controlled.
- (b) The liabilities to be assumed by Controlled in the transfer were incurred in the ordinary course of business and are associated with the assets transferred.
- (c) It is not expected that any of the property transferred from Distributing to Controlled will be property with regard to which any investment credit under § 46 of the Internal Revenue Code has or will be claimed or with regard to which any investment credit is required to be recaptured. However, in the event that any of the property transferred is such property, then the investment tax credit previously computed with respect to such property transferred (including any building to

which § 47(d) applies) will be adjusted in the year of transfer to reflect an early disposition of the property pursuant to § 47(a)(1) and (5).

- (d) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of this transaction.
- (e) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, step (II).
- (f) No two parties to the transaction (that is, Distributing and Controlled) are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (g) Neither Distributing nor Controlled has, or at the time of the transactions will have, any securities, warrants, or options outstanding.
- (h) The transaction will not constitute a disqualified distribution within the meaning of §355(d). None of the outstanding Distributing stock was acquired by either Shareholder A or B by purchase within the meaning of § 355(d)(5), and none of the stock in Distributing or Controlled will be "disqualified stock" within the meaning of § 355(d)(3).
- (i) Shareholder A will receive solely common stock in Controlled in exchange for his stock in Distributing.
- (j) Distributing, Controlled, and the shareholders will each pay their own expenses incurred in connection with the transaction.
- (k) The fair market value of the stock of Controlled received by Shareholder A will approximately equal the fair market value of the Distributing stock surrendered by such shareholder in the exchange.
- (l) No part of the stock in Controlled received by Shareholder A is being received as a creditor, employee, or in any capacity other than as a shareholder of Distributing.
- (m) The 5 years of financial information submitted on behalf of Distributing for Business A is representative of such business' present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.

- (n) In the transaction, the shareholders of Distributing will not transfer or surrender any property other than common stock of Distributing.
- (o) Following the proposed transactions, Distributing will continue, independently and with its separate employees, to be directly engaged in the active conduct of Business A which Distributing will have actively conducted within the meaning of § 1.355-3(b)) throughout the 5-year period immediately prior to the step (II) stock distribution. In each of the preceding 5 years, Business A will have employed over 10 full-time employees: four employees primarily managerial and the remainder primarily operational. Following step (II), Distributing's Business A will have more than five full-time employees who will continue to conduct the operational and managerial activities of Business A: one or two employees primarily managerial and other employees primarily operational.
- (p) Following the proposed transactions, Controlled will continue, independently and with its separate employees, to be directly engaged in the active conduct of Business A which previously was actively conducted (within the meaning of § 1.355-3(b)) by Distributing throughout the 5-year period immediately prior to step (II). Following step (II), Controlled's Business A will have more than five full-time employees who will continue to conduct the operational and managerial activities of Business A: one or two employees primarily managerial and other employees primarily operational.
- (q) Following step (II), both Distributing and Controlled will continue to use outside employees for certain specialized functions, such as legal and accounting services, and to perform specialized maintenance functions. At no time, however, have, or will, outside employees constitute a majority of the employees of either Distributing or Controlled, or perform a majority of either the managerial or operational activity for either business.
- (r) It is not planned or intended for there to be any continuing transactions between Distributing and Controlled following step (II). If any transactions occur, payments made in connection with all continuing transactions 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.

- (s) The distribution of the stock of Controlled in step (II) is being carried out for the following corporate business purpose: to eliminate the shareholder deadlock that is preventing Distributing from engaging in short and long term planning. The distribution of Controlled stock is motivated, in whole or substantial part, by this corporate business purpose.
- (t) There will have been no changes in the ownership of either Distributing or Controlled in the 5-year period prior to step (II).
- (u) There is no plan or intention to liquidate either Distributing or Controlled, to merge either Distributing or Controlled with any other corporation, or to sell or otherwise dispose of the assets of either Distributing or Controlled, subsequent to the transactions, except for dispositions of assets in the ordinary course of business.
- (v) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary, to purchase any of its outstanding stock after the transactions.
- (w) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, have redeemed, or otherwise dispose of any of their stock in Distributing or Controlled subsequent to the transactions.
- (x) Step (II), above, is not part of a plan or series of related transactions (within the meaning of § 355(e)), including investments in Distributing or Controlled, pursuant to which one or more persons will acquire (except as allowed by § 355(e)) 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.
- (y) There have not been, and there will not be, any other transactions that are related to steps (I) and (II) above.
- (z) Neither Distributing nor Controlled is, plans, or intends to be an S corporation within the meaning of § 1361(a).

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

- (1) The transfer in step (I) by Distributing to Controlled of assets, as described above, followed by the distribution in step (II) by Distributing of all of the Controlled stock to Shareholder A is a reorganization within the meaning of §§ 368(a)(1)(D) and 355.

Distributing and Controlled each will be a "party to a reorganization" within the meaning of § 368(b).

- (2) No gain or loss will be recognized by Distributing upon the transfer of assets, subject to liabilities, to Controlled in exchange for Controlled stock, as described above (§§ 361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled on the receipt of Distributing assets in exchange for Controlled stock (§ 1032(a)).
- (4) The basis of each asset received by Controlled will be the same as the basis of such asset in the hands of Distributing immediately prior to the transfer (§ 362(b)).
- (5) The holding period of the assets received by Controlled will include the period during which such assets were held by Distributing (§ 1223(2)).
- (6) No gain or loss will be recognized by Distributing upon the distribution to Shareholder A of all the Controlled stock (§ 361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder A upon receipt of the Controlled stock (§ 355(a)(1)).
- (8) The basis of the Controlled stock in the hands of Shareholder A will be the same as the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).
- (9) The holding period of the Controlled stock received by Shareholder A will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset by Shareholder A on the date of the exchange (§ 1223(1)).

- (10) Proper allocation of earnings and profits will be made

between Distributing and Controlled under § 1.312-10(a) of the Income Tax Regulations (§ 312(h)).

No opinion is expressed about the tax treatment of the proposed transactions under any other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transactions not specifically covered by the above rulings.

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

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this letter are consummated.

Pursuant to the power of attorney on file in this matter, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By _____
Christopher Schoen
Assistant Branch Chief, Branch 1