

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

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CC:CORP:B03

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Date:

March 01, 2007

Distributing =

Controlled =

State X =

State Y =

Business A =

Business B =

c =

d =

Shareholder 1 =

Dear

We respond to your December 11, 2006, request for rulings on certain Federal income tax consequences of a proposed transaction. Additional information was submitted in a letters dated January 30, and February 28, 2007. The information submitted is summarized below.

The rulings contained in this letter are based upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material 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.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether any distribution described below satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, whether any of the distributions described below is used principally as a device for the distribution of earnings and profits of Distributing or Controlled or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)), or whether any distribution described below 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 § 355(e) and § 1.355-7).

Summary of Facts

Distributing, a State X corporation, has elected to be treated as an S corporation. Distributing conducts Business A and Business B. Distributing uses the cash method of accounting on a calendar year basis. Distributing has voting common stock outstanding which is held by c shareholders.

The financial information submitted by Distributing indicates that Business A and Business B each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing wishes to separate Business B from Business A to cut costs and diffuse certain shareholder conflicts between Shareholder 1 and the other shareholders of Distributing concerning the operations of Business A and Business B. Accordingly, the following transaction has been proposed.

Proposed Transaction

- (i) Distributing will organize Controlled as a State Y corporation with 1,000 shares of voting common stock outstanding. Controlled will elect to be an S corporation and use the cash method of accounting. Distributing will

transfer all of the assets involved in Business B to Controlled in exchange for all of the Controlled stock (the "Contribution").

- (ii) Distributing will distribute all of its voting Controlled common stock to Shareholder 1 in exchange for shares of his Distributing stock (the "Distribution").

Representations

- (a) The fair market value of the Controlled stock to be received by Shareholder 1 will be approximately equal to the fair market value of the Distributing stock surrendered by Shareholder 1 in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by Shareholder 1 as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The five years of financial information submitted on behalf of Distributing are representative of its present operations and with respect to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (e) The Distribution is being carried out to separate the geographically isolated Business B from Business A. The separation will allow each business to cut costs and be more profitable. The separation will also diffuse certain shareholder conflicts between Shareholder 1 and the other Distributing shareholders. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (f) The Distribution will not be used principally as a device for the distribution of earnings and profits of Distributing or Controlled or both.
- (g) No liabilities will be assumed (within the meaning of § 357(d)) by Controlled in the transaction.
- (h) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (i) 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.

- (j) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 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 § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (k) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 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 § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (l) The Distribution is not part of a plan or series of related transactions (within the meaning of § 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 § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) Immediately after the transaction (as defined in § 355(g)(4)) neither Distributing nor Controlled will be a “disqualified investment corporation” within the meaning of § 355(g)(2).
- (o) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the transaction.

Rulings

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

- (1) The Contribution by Distributing to Controlled, followed by the distribution of the Controlled stock to Shareholder 1 will qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be a party to the reorganization within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing on the Contribution solely in exchange for Controlled stock (§ 361(a)).
- (3) No gain or loss will be recognized by Controlled on the Contribution in exchange for Controlled stock (§ 1032(a)).
- (4) The basis of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).
- (5) The holding period of each asset received by Controlled in the Contribution will include the holding period of that asset in the hands of Distributing (§ 1223(2)).
- (6) Distributing will recognize no gain or loss on the Distribution (§ 361(c)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder 1 on the Distribution (§ 355(a)(1)).
- (8) The basis of the Controlled stock in the hands of Shareholder 1 will be the same as the basis of the Distributing stock exchanged therefor (§ 358(a)(1)).
- (9) The holding period of the Controlled stock in the hands of Shareholder 1 will be the same as the holding period of the Distributing stock exchanged therefor, provided the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a).

We express no opinion about the tax treatment of any transaction described above under other provisions of the Code and regulations or the tax treatment of any condition existing at the time of, or effect resulting from, any of these transactions that is not specifically covered by the above rulings. In particular, no opinion is requested and no opinion is expressed regarding whether the Distribution satisfies the business purpose requirement of § 1.355-2(b), whether the transaction is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

(see § 355(a)(1)(B) and § 1.355-2(d)), and whether the proposed transaction is part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii).

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

Pursuant to the power of attorney on file in this office, a copy of this letter is being sent to Distributing's authorized representative.

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.

Sincerely,

Ken Cohen
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel (Corporate)