

Internal Revenue Service

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Date:

December 17, 2003

Re.:

Legend

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Business A =

Percent 1 =

State A =

Percent 3 =

Percent 4 =

Percent 5 =

Dear

This is in response to your representative's letter dated August 5, 2003, requesting rulings under § 355 of the Internal Revenue Code (the "Code") with respect to a proposed transaction. Additional information was received in letters dated September 30, 2003, October 29, November 25, 2003 and December 16, 2003. The material information submitted is summarized below.

Distributing is a State A corporation that files its federal income tax return on a fiscal year basis ending November 30th using the cash method of accounting. Distributing has a single class of stock and no securities outstanding. The stock of Distributing is owned Percent 1 each by Shareholders A and B, and Percent 3 by Shareholder C, Percent 4 by Shareholder D, and Percent 5 by Shareholder E.

Distributing is engaged in Business A. Financial information has been received indicating that Business A has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five years. In an attempt to increase certain governmental subsidies, and to maximize economic performance, Distributing proposes the following steps to implement a corporate division of Business A.

1. Distributing will form a subsidiary, Controlled, and will contribute to Controlled certain assets of Business A in exchange for all of the stock of Controlled and the assumption by Controlled of certain Distributing liabilities.
2. Distributing will distribute one-half of the stock of Controlled to each of Shareholders A and B in exchange for all of their stock of Distributing (the "Distribution").

Distributing has made the following representations with respect to the proposed series of transactions:

- (a) The fair market value of the Controlled stock and other consideration to be received by Shareholder A and Shareholder B will be approximately equal to the fair market value of their Distributing stock surrendered in the exchange.

(b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.

(c) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior thereto.

(d) The Distribution of the stock of Controlled is carried out for the following corporate business purposes: (1) to increase certain governmental subsidies in respect of Business A; and (2) to maximize economic performance. The distribution of the stock of Controlled is motivated, in whole or substantial part, by these corporate business purposes.

(e) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in or securities of, either Distributing or Controlled after the transaction.

(f) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

(g) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operations, and with regard thereto, there have been no substantial operational changes since the date of the last financial statement submitted.

(h) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.

(i) The total adjusted bases and fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.

(j) The liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

(k) No inter-corporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.

(l) In the event that Controlled guarantees a portion of the debt of Distributing, Distributing will pay an arm's length fee to Controlled to compensate for the granting of the guarantee.

(m) 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.

(n) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

(o) 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 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.

(p) 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 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 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.

(q) Taking certain intra family gifts of the stock of Distributing into account, the Distribution is not a part of a plan or series of related transactions (within the meaning of section 355(e), pursuant to which one or more persons will acquire directly or indirectly stock possessing fifty percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing fifty percent or more of the total value of all classes of stock of either Distributing or Controlled.

(r) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the transaction.

(s) Distributing is not an S corporation (within the meaning of section 1361(a)), and there is no plan or intention by it or Controlled to make an S corporation election pursuant to section 1362(a).

(t) Distributing and Controlled will each pay its own expenses of the proposed transaction.

(u) Following the proposed transaction, neither Distributing nor Controlled will guarantee, collateralize, or accommodate in any way, any debt of the other corporation without arms length consideration.

(v) Shareholders A and B will not acquire any Distributing stock after the Transaction. Shareholder A will not be a shareholder, employee, officer, or director of Distributing after the Transaction. Shareholder B will not be a shareholder, officer, or director of Distributing after the Transaction. Distributing intends to continue to employ _____ in the capacity of bookkeeper on a part time basis. Shareholders C, D, and E will not acquire any Controlled stock after the Transaction. Shareholders C, D, and E will not be shareholders, employees, officers, or directors of Controlled after the Transaction.

Based solely on the information provided and the representations made, we conclude as follows:

(1) The transfer of certain Business A assets by Distributing to Controlled in exchange for all the stock of Controlled and the assumption of certain Distributing liabilities described above, followed by the distribution of all of the Controlled stock to Shareholders A and B, in exchange for all of the Distributing stock owned by these Shareholders will be a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be a "party to the reorganization" within the meaning of section 368(b).

(2) No gain or loss will be recognized by Distributing upon the transfer of certain Business A assets to Controlled in exchange for the Controlled stock and assumption of certain Distributing liabilities as described above (sections 361(a) and 357(a)).

(3) No gain or loss will be recognized by Distributing upon the distribution of all the stock of Controlled (section 361(c) (1)).

(4) No gain or loss will be recognized by Controlled upon the receipt of the assets and liabilities of Business A in exchange for all the shares of the Controlled stock (section 1032(a)).

(5) The basis of each of the assets to be received by Controlled in the transaction will equal the basis of such asset in the hands of distributing immediately prior to the transaction (section 362(b)).

(6) The holding period of each of the assets to be received by Controlled will include the period during which Distributing held such assets (section 1223(2)).

(7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholders A and B, upon the receipt of Controlled stock in exchange for their Distributing stock, respectively (section 355(a)(1)).

(8) The basis of the Controlled stock to be received by Shareholders A and B, will be the same as the basis of the Distributing stock surrendered in exchange therefore (section 358(a)(1)).

(9) The holding period of the Controlled stock to be received by Shareholders A and B, will include the holding period of the Distributing stock surrendered by such shareholders in exchange therefore, provided that the Distributing stock is held as a capital asset on the date of the exchange (section 1223(1)).

(10) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under section 1.312-10(a).

No opinion is expressed as to the tax treatment of the transaction under 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 transaction that are not specifically covered by the above ruling.

In accordance with a power of attorney on file in this office, copies of this letter are being sent to the authorized party.

A copy of this letter must be attached to the federal income tax return of the taxpayers involved for the taxable year in which the transaction is consummated.

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

Sincerely,

Alison Burns

Alison Burns
Assistant Branch Chief, Branch 2
Office of Associate Chief Counsel, Corporate