

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

In Re:

Refer Reply To:

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Date:

May 12, 2004

Legend:

Distributing =
State A =
Date 1 =
ww =
xx =
yy =
zz =

Asset A =
Asset B =
Business A =
Business B =

Dear

This letter responds to your November 13, 2003 request for rulings submitted on behalf of Distributing regarding certain federal income tax consequences of a proposed transaction. Additional information was received in later correspondence. The information submitted in the November 13, 2003 request and in the later correspondence is summarized below.

The rulings contained in this letter are based on 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 materials 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. Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the proposed transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporations or of all three of the corporations (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)), and (iii) 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 the distributing corporation or of either of the controlled corporations (see § 355(e)(2)(A)(ii) and § 1.355-7T).

Distributing was formed on Date 1 in State A. Distributing has one class of stock that is owned by a small group of shareholders. Distributing's business is comprised of several activities including: ww, xx, yy, and zz. Distributing has supplied financial information indicating that its business has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing has indicated that it wants to develop two new businesses (Business A and Business B) by exploiting certain of its assets (Asset A and Asset B). Distributing has represented that to preserve its current financing situation and to secure the financing for developing Business A and Business B, they must be developed in entities that are not connected to Distributing.

Distributing, therefore, proposes the following transaction: Distributing will create Controlled 1 and Controlled 2. Distributing will contribute Asset A and Asset B to Controlled 1 and Controlled 2, respectively. In addition, Distributing will contribute some, but not all, of its current business activities to both Controlled 1 and Controlled 2. Distributing has indicated that Controlled 1 and Controlled 2 will not be assuming any liabilities of Distributing, nor are the assets that Distributing will contribute to Controlled 1 and Controlled 2 subject to liabilities. Distributing will distribute all the stock of Controlled 1 and Controlled 2 to its shareholders in accordance with their pro rata ownership of Distributing.

In connection with these proposed transactions, Distributing has made the following representations:

- a) No part of the consideration distributed by Distributing will be received by any shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- b) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements, submitted.
- c) Following the transaction, Distributing, Controlled 1, and Controlled 2 will each continue, independently and with its separate employees, the active conduct of its share of the integrated activities of the business conducted by Distributing.
- d) The distribution of the stock of Controlled 1 and Controlled 2 is carried out for the following business purpose: to preserve Distributing's current financing and to obtain financing for Business A and Business B. The distribution of the stock of

Controlled is motivated, in whole or substantial part, by this corporate business purpose.

- e) The transaction is not used principally as a device for the distribution of the earnings or profits of Distributing or of either Controlled 1 or Controlled 2.
- f) Distributing neither accumulated its receivables, nor made extraordinary payment of its payables in anticipation of the transaction.
- g) No intercorporate debt will exist between Distributing and Controlled 1 or Controlled 2 at the time of or subsequent to, the distribution of the controlled corporations' stock.
- h) No two parties to the transactions are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- i) Payments made in connection with all continuing transactions, if any, between Distributing, Controlled 1, and Controlled 2 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- j) The distributions are not part of a plan or series of related transactions (within the meaning section 1.355-7T) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50 percent or greater interest (within the meaning of section 355(d)(4)) in Distributing, Controlled 1, or Controlled 2 (including any predecessor or successor).
- k) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing that was either (i) acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions of Distributing stock that was acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- l) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of either Controlled 1 or Controlled 2 stock entitled to vote or 50 percent or more of the total value of shares of all classes of either Controlled 1 or Controlled 2 stock that was either (i) acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to

distributions of Distributing stock that was acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

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

1. Each of the transfers of the Distributing assets to Controlled 1 and to Controlled 2 in exchange for all of their stock, followed by the distribution of the stock of Controlled 1 and Controlled 2 to the shareholders of Distributing will each constitute a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled 1 will be each "a party to the reorganization" within the meaning of section 368(b) of the Code. Distributing and Controlled 2 will also each be "a party to the reorganization" within the meaning of section 368(b).
2. Distributing will recognize no gain or loss on the transfer of the assets to Controlled 1 and Controlled 2 in exchange for the respective stock of Controlled 1 and Controlled 2. (Section 361(a)).
3. Neither Controlled 1 nor Controlled 2 will recognize gain or loss on its receipt of the transferred assets from Distributing in exchange for its stock. (Section 1032(a)).
4. The basis of the assets received by Controlled 1 and Controlled 2 will be the same as the basis of the assets in the hands of Distributing immediately prior to the transaction. (Section 362(b)).
5. The holding period of the assets transferred to Controlled 1 and Controlled 2 will include the period during which such assets were held by Distributing. (Section 1223(2)).
6. No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing upon receipt of the stock of Controlled 1 and Controlled 2. (Section 355(a)).
7. The aggregate basis of the Distributing, Controlled 1, and Controlled 2 stock in the hands of each shareholder will equal the aggregate basis of the Distributing stock held immediately before the distribution, allocated between the stock of Distributing, Controlled 1, and Controlled 2 in proportion to the relative fair market value of each immediately following the distribution. (Section 358(b)).
8. The holding period of the Controlled 1 and Controlled 2 stock received by a Distributing shareholder will include the holding period of the Distributing stock

with respect to which the distribution will be made, provided that the Distributing stock is held as a capital asset on the date of exchange. (Section 1223(1)).

9. No gain or loss will be recognized by Distributing on its distribution of all its Controlled 1 and Controlled 2 stock. (Section 361(c)).
10. A proper allocation of earnings and profits between Distributing, Controlled 1, and Controlled 2 will be made in accordance with section 312(h) of the Code and 1.312-10(a) of the Income Tax Regulations.

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the proposed transaction is used principally as a device for the distribution of the earnings and profits of distributing corporation or of any of the two controlled corporations, or of all three of the corporations (see § 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii).

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

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

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

Sincerely,

Steven J. Hankin

Steven J. Hankin
Senior Technical Reviewer, Branch 6
Office of Associate Chief Counsel
(Corporate)