

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date:

July 15, 2004

Distributing =

Controlled =

Business A =

Shareholder A =

Shareholder B =

Shareholder C =

a =

b =

c =

d =

Asset X =

Asset Y =

Asset Z =

Dear :

This letter responds to your April 5, 2004 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in 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 or controlled corporation or both (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 or controlled corporation (see § 355(e)(2)(A)(ii) and § 1.355-7T).

Summary of Facts

Distributing is a closely held corporation that conducts Business A. Distributing has one class of common stock outstanding. Shareholder A owns a percent, Shareholder B owns b percent, Shareholder C owns c percent, and the remaining shareholders own d percent. Shareholder A and Shareholder B manage Business A for Distributing (the "Managing Shareholders").

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

For the last few years, Shareholder A and Shareholder B have increasingly disagreed about fundamental matters relating to Distributing's operations and future direction. To eliminate these conflicts, Distributing and the Managing Shareholders have agreed to the following partially completed and proposed transaction (collectively, the "Proposed Transaction"):

- (i) Distributing contributed Asset X and Asset Y to newly formed Controlled in exchange for all of Controlled's outstanding stock. Before the Distribution described below, Distributing will transfer Asset Z to Controlled in

constructive exchange for Controlled stock (the Asset X, Asset Y, and Asset Z transfers, collectively, the "Contribution").

- (ii) Distributing will distribute all of its Controlled stock to Shareholder A and Shareholder C in exchange for all their stock in Distributing (the "Distribution").

Representations

The taxpayer has made the following representations in connection with the Proposed Transaction:

- (a) The fair market value of the Controlled stock received by Shareholder A and Shareholder C will approximately equal the fair market value of the Distributing stock surrendered by the shareholder in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by Shareholder A or Shareholder C as a creditor, employee, or in any capacity other than that of a Distributing shareholder.
- (c) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the Proposed 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 for the following business purpose: to resolve the disputes between Shareholder A and Shareholder B. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (f) The Proposed Transaction is not being used principally as a device for the distribution of the earnings or profits of Distributing or Controlled or both.
- (g) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing in the Contribution will, in each instance, equal or exceed the liabilities assumed (as determined under § 357(d)) by Controlled plus any liabilities to which any transferred assets were subject.
- (h) The liabilities assumed (as determined under § 357(d)) in the Contribution and the liabilities to which the transferred assets are subject were incurred in

the ordinary course of business and are associated with the assets transferred.

- (i) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.
- (j) No two parties to the transactions are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (k) 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.
- (l) There is no acquisition of stock of Distributing or Controlled (including any predecessor or successor of Distributing or Controlled) that is part of a plan or series of related transactions (within the meaning of § 1.355-7T) that includes the distribution of Controlled stock.
- (m) 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 entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing 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.
- (n) 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 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.

Rulings

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

- (1) The Contribution, followed by the Distribution will qualify as a reorganization under § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" under § 368(b).

- (2) Distributing will recognize no gain or loss on the Contribution (§ 357(a) and § 361(a)).
- (3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).
- (4) The basis that Controlled has in each asset received from Distributing in the Contribution will equal the basis of that asset in the hands of Distributing immediately before its transfer (§ 362(b)).
- (5) The holding period of each asset received by Controlled in the Contribution will include the period Distributing held that asset. (§ 1223(2)).
- (6) No gain or loss will be recognized by Distributing 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 A or Shareholder C upon their receipt of Controlled stock in exchange for their Distributing stock. (§ 355(a)).
- (8) The basis of the Controlled stock in the hands of Shareholder A and Shareholder C after the Distribution will equal the basis of the respective Distributing stock surrendered by each shareholder in the exchange therefore. (§ 358(a)).
- (9) The holding period of the Controlled stock received by Shareholder A and Shareholder C will, in each instance, include the holding period of the respective Distributing stock surrendered by each shareholder, provided such stock is held as a capital asset on the date of the Distribution. (§ 1223(1)).
- (10) A proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 312(h) and § 1.312-10(a).

Caveats

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 or Controlled or both (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).

Procedural Statements

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.

Each taxpayer involved in this transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return in the year in which the Proposed Transaction is completed.

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

Sincerely,

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel

(Corporate)

cc: