

Internal Revenue Service

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Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:B02

PLR-115877-05

Date:

July 21, 2005

TY:

LEGEND:

Distributing

Controlled

Shareholder A =

Shareholder B

Shareholder C =

State F =

Date 1 =

Date 2 =

Date 3 =

Business D =

Business E =

F =

G =

H =

I =

Dear :

This is in reply to your letter requesting rulings about the transaction described in this letter. The information submitted for consideration is substantially as set forth 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.

Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding, whether the proposed transaction described below: (i) satisfies the business purpose requirement of section 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 section 355(a)(1)(B) of the Internal Revenue Code and section 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 section 355(e) and section 1.355-7)).

Summary of Facts

Distributing was incorporated in State F on Date 1. On Date 2, it elected to be taxed as a Subchapter S corporation. Distributing has one class of stock with I shares outstanding. Shareholder A owns F shares, Shareholder B owns G shares and Shareholder C owns H shares of Distributing. Since its incorporation, Distributing has engaged to two active businesses, Business D and Business E.

Controlled was formed on Date 3. It also has one class of voting common stock with I shares outstanding.

The shareholders of Distributing have developed their own separate, distinct business philosophies that have given rise to disagreements which, if permitted to continue, would jeopardize the corporate operations and continued success of the two

active businesses conducted by Distributing. In order to resolve their differences, the shareholders have decided to separate certain assets of Business D and Business E from Distributing into Controlled and give Shareholder C independence and exclusive control of Controlled and its business plans.

Proposed Transaction

To accomplish these objectives, the following transaction is proposed:

- (i) Distributing will transfer assets and liabilities used in both Business D and Business E to Controlled in exchange for I shares of Controlled.
- (ii) Distributing will distribute I shares of Controlled to Shareholder C in exchange for all of the stock in Distributing that Shareholder C owns.
- (iii) Distributing will retire the shares of its stock surrendered to it by Shareholder C.

Representations

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

- (a) The fair market value of Controlled stock to be received by Shareholder C will be approximately equal to the fair market value of Distributing stock surrendered by the shareholder in the exchange.
- (b) No part of the consideration to be distributed by Distributing is being received by Shareholder C as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) 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.
- (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 of the stock of Controlled will be carried out to promote management harmony and avoid significant disagreements between the shareholders of Distributing concerning the management and operation of Business D and Business E and to permit Shareholder C independence and exclusive control of the new corporation and its businesses. The distribution of the stock, or stock and securities, of Controlled is motivated in whole or substantial part by one or more of these corporate business

purposes.

- (f) The proposed transaction is not used principally as a device for the distribution of the earnings and profits of the Distributing Corporation or the Controlled Corporation or both.
- (g) The total adjusted bases and the fair market value of the assets transferred to Controlled Corporation by Distributing Corporation each equals or exceeds the sum of the liabilities assumed by Controlled Corporation plus any liabilities to which the transferred assets are subject.
- (h) The liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary business and are associated with the assets being transferred.
- (i) No property is being transferred between Distributing and Controlled that would be subject to investment credit recapture.
- (j) This transaction will not result in a situation in which one party recognizes income but another party recognizes the deductions associated with such income or one party owns property but another party recognizes the income associated with such property
- (k) No income items, such as accounts receivable or any items resulting from a sale exchange or disposition that would have resulted in income to Distributing Corporation or any items of expense will be transferred to Controlled.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the stock of Controlled.
- (m) Payments made in connection with 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 Code section 368(a)(2)(F)(iii) and (iv).
- (o) For purposes of Code section 355(d), immediately after the Distribution, no person (determined after applying Code section 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 Code section 355(d)(5) and (8)) during the five-year period (determined after applying Code section 355(d)(6)) ending on the date of the distribution.

- (p) For purposes of Code section 355(d), immediately after the distribution, no person (determined after applying Code section 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 Code section 355(d)(5) and (8)) during the five-year period (determined after applying Code section 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 Code section 355(d)(5) and (8)) during the five-year period (determined after applying Code section 355(d)(6)) ending on the date of the distribution.
- (q) There is no acquisition of stock of the Distributing Corporation or any Controlled Corporation (including any predecessor of any such corporation) that is part of a plan or series of related transactions within the meaning of section 1.355-7 that includes the distribution of the Controlled Corporation stock.
- (r) The gross assets of the portion of the business directly conducted by Distributing immediately after the distribution will have a fair market value that is greater than 5 percent of the total fair market value of Distributing's gross assets at that time.
- (s) The gross assets of the portion of the business to be conducted by Controlled immediately after the distribution will have a fair market value that is greater than 5 percent of the total fair market value of Controlled's gross assets at that time.

Rulings

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

- (1) The transfer by Distributing to Controlled of assets relating to Business D and Business E solely in exchange for all of the outstanding stock of Controlled followed by the distribution of all of the Controlled stock to Shareholder C in exchange for Distributing stock as described above will be a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled will each be a "party to a reorganization" within the meaning of section 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of assets to Controlled in exchange for Controlled stock as described in (ii) above. Sections 357(a) and 361(a).

- (3) Controlled will recognize no gain or loss on the receipt of the assets of Distributing in exchange for all of the shares of Controlled. Section 1032(a).
- (4) The basis of each asset received by Controlled will equal the basis of such asset in the hands of Distributing immediately prior to the proposed transaction. Section 362(b).
- (5) The holding period of the assets received by Controlled from Distributing will include the period during which such assets were held by Distributing. Section 1223(2).
- (6) Distributing will recognize no gain or loss upon the distribution of all its Controlled stock to Shareholder C. Section 361(c).
- (7) Shareholder C will not recognize gain or loss (and no amount will be included in the income of Shareholder C) upon the receipt of Controlled stock in exchange for Distributing stock of equal value. Section 355(a)(1).
- (8) The basis in the stock of Controlled to be received by Shareholder C will equal the basis of the Distributing stock surrendered by Shareholder C in the exchange. Section 358(a).
- (9) The holding period of the Controlled stock received by Shareholder C will include the holding period of the Distributing stock surrendered in exchange therefore, provided that the Distributing stock was held as a capital asset by Shareholder C on the date of the exchange. Section 1223(1).
- (10) As provided in Section 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with section 312 and section 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 about 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 whether the proposed transaction: satisfies the business purpose requirement of section 1.355-2(b); is used principally as a device for the distribution of the earnings and profits of the distributing or controlled corporation or both (see section 355(a)(1)(B) of the Internal Revenue Code and section 1.355-2(d)); 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.

Procedural Statements

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

A copy of this letter should be attached to the federal income tax returns of each of the taxpayers involved for the taxable year in which the transaction covered by this ruling is consummated.

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,

Gerald B. Fleming
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel (Corporate)