

Internal Revenue Service

Department of the Treasury

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Date:

April 24; 2001

Distributing =

Controlled =

State A =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Employee F =

Employee G =

a% =

b% =

c% =

d% =

#a =

#b =

People A =

a =

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b	=
<u>c</u>	=
<u>d</u>	=
e	=
<u>f</u>	=
<u>g</u>	=
<u>h</u>	=
<u>i</u>	=
j	=
<u>k</u>	=
A	=

This letter is in reply to your letter dated October 18, 2001 requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated January 3, 2001 and March 28, 2001. The information submitted for consideration is summarized below.

Distributing is an State A corporation on the cash-basis method of accounting. Distributing is directly engaged in Business A through salaried employees and independent contractors. The independent contractors are People A. People A perform the following activities: b, c, and d with regard to the a's. People A are compensated by receiving a share of the a resulting from the business of A activity

Distributing has #a shares of common stock outstanding all voting. The shares are held as follows: Shareholder A (a%); Shareholder B (b%); Shareholder C (c%); Shareholder D (d%).

Shareholder C acts as the Chief Executive Officer of Distributing and is an employee of Distributing. She is responsible for the conduct and operation of Distributing and for carrying out all orders and resolutions of the board of Distributing. Shareholder C enters into and executes on behalf of Distributing all contracts, bids, offers, bonds mortgages, deeds and conveyances and other corporate commitments. Shareholder C is responsible for maintaining overall surveillance over business of A activity operations and determining appropriate actions regarding business of A activity

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management, operations, agreements, e and sales. Shareholder C makes all financing and insurance determinations for business of A activity. In addition, she determines working capital requirements for maintaining f. She participates in decisions concerning sales and maintenance as well as operations of business of A activity.

Employee F is a full time employee of Distributing. Employee F devotes almost all her time to the business of A activities. She is responsible for day-to-day business of A management activities, including the actions of People A. She does the purchasing of equipment, g, h and i, and k. In addition, she arranges for j and sells Distributing's portion of the a.

Controlled will be formed as a corporation on the cash-basis method of accounting to effectuate the proposed transaction. Controlled will have #b shares of common stock outstanding, which will be initially owned by Distributing. Controlled will be directly engaged in business of A activity.

Financial information indicates that Distributing's business of A activity operations have had gross receipts and operating expenses representative of an active trade or business for each of the past five years.

Serious disputes have arisen between Shareholders A and B and Shareholders C and D regarding the management, operations, and direction of Distributing's business. To enable Shareholder's C and D to sever their relationship with Shareholders A and B, the following transaction has been proposed:

- (i) Distributing will transfer a portion of its business of A activity assets to Controlled in exchange for shares of Controlled stock. No investment credits will be claimed with respect to the property transferred.
- (ii) Immediately thereafter, Distributing will distribute all of the Controlled stock to Shareholder's A and B in exchange for all of their stock in Distributing.

Following the transaction, Shareholders A and B will continue to engage in the same type of operations that Distributing engaged in prior to the distribution. Shareholder B will become an employee of Controlled. Her position will be director of business of A activity operations. She will be responsible for the conduct and operation of Controlled and for carrying out all orders and resolutions of the board of Controlled. Shareholder B enters into and executes on behalf of Controlled all contracts, bids, offers, bonds mortgages, deeds and conveyances and other corporate commitments. Shareholder B is responsible for maintaining overall surveillance over business of A activity operations and determining appropriate actions regarding business of A activity management, operations, agreements, e and sales. Shareholder B provides all financing and insurance determinations for business of A activity. In addition, she determines working capital requirements for f and makes decisions with regard to sales,

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maintenance and operations.

Employee G will be a full time employee of Controlled. Employee G will devote almost all his time to business of A activity. He will be responsible for day to day business of A activities, and the actions of the independent contractors. His duties will include the purchasing of equipment, g, h and i, and k. In addition, he will arrange for j, and sell Controlled's portion of the a. Additional salaried employees will be hired as needed by Controlled. Controlled will hire People A as independent contractors. People A will b, c and d the a's

Distributing will continue to engage in business of A activity after the distribution. Shareholder C will remain an employee of Distributing. Her position will be director of business of A activity operations. Her duties will be the same as those she performed prior to the distribution. The remaining employees will become independent contractors performing business of A management duties for Distributing and Controlled. People A will continue to be employed as independent contractors by Distributing. No employees will be shared by Distributing and Controlled.

The following representations have been made in connection with the proposed transaction:

- (a) The fair market value of the Controlled stock to be received by Shareholder A and Shareholder B will be approximately equal to 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 a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The 5 years of financial information submitted on behalf of the Distributing corporation is representative of the corporation's present operation, and, with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements.
- (d) Following the proposed distribution, the Distributing and Controlled corporations 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 the Distributing corporation prior to the consummation of the transaction.
- (e) The distribution of the stock of the Controlled corporation is carried out for the following corporate business purpose: to eliminate shared management, shared decision making, and shared financial results in the existing single Distributing corporation. The distribution of stock of the Controlled

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corporation is motivated, in whole or in substantial part, by one or more of these corporate business purposes.

- (f) The Distributing corporation is not an S corporation (within the meaning of Section 1361(a)), but immediately before the distribution, the Distributing corporation will be eligible to make an S corporation election pursuant to Section 1362(a). There is no intention by Distributing to make an S election after the transaction, but it may at some future undefined date. Controlled will elect to be an S corporation pursuant to Section 1362(a) on the first available day after the distribution, and there is no plan or intention to revoke or otherwise terminate the S corporation election of Controlled.
- (g) After the transaction is complete, the resulting corporations do not intend to sell any of the corporation's stock in the foreseeable future in order to attempt to gain capital-gain treatment.
- (h) There is no plan or intention by the shareholders or security holders of the Distributing corporation to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either the Distributing or Controlled corporations after the transaction.
- (i) There is no plan or intention by either the Distributing corporation or the the Controlled corporation, 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.
- (j) There is no plan or intention to liquidate either the Distributing or the Controlled corporations, 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.
- (k),(i)The total adjusted basis and the fair market value of the assets transferred to the Controlled corporation by the Distributing corporation each equals or exceeds the sum of the liabilities assumed by the Controlled corporation plus any liabilities to which the transferred assets are subject; and (ii) the liabilities assumed in the transaction and the liabilities to which transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (l) No property is being transferred between Distributing and Controlled in which an investment tax credit determined under section 46 of the Code has

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been (or will be) claimed with respect to such property.

- (m) The Distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (n) Immediately before the distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Further, Distributing's excess loss account with respect to the Controlled stock will be included in income immediately before the distribution.
- (o) Payments made in connection with all continuing transactions, if any, between the Distributing and Controlled corporations, will be for fair market value based on the terms and conditions arrived at by the parties bargaining at arm's length.
- (p) No two parties to the transaction are investment companies as defined in section 368(2)(F)(iii) and (iv) of the Internal Revenue Code.
- (q) No Distributing shareholder or shareholders will hold immediately after the distribution disqualified stock within the meaning of section 355(d)(3) which constitutes a 50% percent or greater interest in Distributing or Controlled.
- (r) The distribution is not 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 50% or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50% or more of the total Value of all classes of stock of either Distributing or Controlled.
- (s) No intercorporate debt will exist between Distributing and Controlled at the time of or subsequent to the proposed distribution.

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

- (1) The transfer by Distributing to Controlled of assets in exchange for Controlled stock, followed by the distribution of Controlled stock to Shareholders A and B of Distributing in exchange for all their stock in Distributing, will constitute a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled are each a "party to a reorganization" within the meaning of section 368(b).

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- (2) No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for Controlled stock (section 361(a)).
- (3) No gain or loss will be recognized by Controlled on the receipt of assets from Distributing in constructive exchange for shares of Controlled stock (section 1032(a)).
- (4) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the transaction (section 362(b)).
- (5) The holding period of each Distributing asset received by Controlled will include the period during which that asset was held by Distributing (section 1223(2)).
- (6) No gain or loss will be recognized by Distributing upon the distribution of all the Controlled stock to Shareholders A and B in exchange for all of their stock in Distributing (section 361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income) of Shareholder A and Shareholder B upon their receipt of the Controlled stock (section 355(a)(1)).
- (8) The basis of the Controlled stock in the hands of Shareholder A and Shareholder B will be the same as the basis of their Distributing stock exchanged therefor (section 358(a)(1)).
- (9) The holding period of the Controlled stock received by Shareholder A and Shareholder B will include the holding period of the Distributing stock exchanged therefor, provided that the Distributing stock is held as a capital asset on the date of the distribution (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) of the income tax regulations.

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not directly covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6110 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 the taxpayers involved for the

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taxable year in which the transaction covered by this ruling letter is consummated.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of the factual information, representations, and other data may be required as part of the audit process.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to your authorized representative.

Sincerely yours,

Associate Chief Counsel (Corporate)

By : Steven J. Hankin
Steven J. Hankin
Special Counsel (Corporate)
CC:CORP:BR06