

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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CC:CORP:B03

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Date:

October 05, 2004

Distributing =

Controlled =

State X =

A =

B =

C =

D =

E =

Business F =

Business G =

h =

k =

l =

m =

n =

o =

p =

q =

r =

s =

t =

w =

Dear

We respond to your request dated June 8, 2004, for rulings on the federal income tax consequences of a proposed transaction. The material information submitted for consideration is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by 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. In particular, this Office has made no determination regarding whether the 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 corporation or both (see §355(a)(1)(B) of the Internal Revenue Code and §1.355-2(d)), or (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 the controlled corporation (see §355(e)(2)(A)(ii) and §1.355-7T).

Distributing is a State X corporation engaged directly in Business F and Business G. The taxpayer has supplied financial information that indicates that each of Business F and Business G had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years. Distributing has outstanding h shares of voting common stock and h shares of non-voting common stock that are owned in the following percentages:

<u>Shareholder</u>	<u>Percent of Voting Common Stock</u>	<u>Percent of Non-Voting Common Stock</u>
A	<u>k</u>	<u>l</u>
B	<u>m</u>	<u>n</u>
C	<u>o</u>	<u>p</u>
D	<u>q</u>	<u>r</u>
E	<u>s</u>	<u>t</u>

None of the above shareholders are related.

Controlled will be formed as a State X corporation and wholly owned subsidiary of Distributing in order to effectuate the proposed transaction.

For what are represented to be valid business purposes, the following transaction is proposed:

- (i) Distributing will transfer Business G to Controlled, together with cash, assets, and liabilities associated with that business, in exchange for w shares of Controlled common stock, constituting all of the outstanding stock of Controlled; and
- (ii) Distributing immediately thereafter will make a pro rata distribution of all of the outstanding stock of Controlled to its shareholders.

The taxpayers have made the following representations in connection with the transaction:

- (a) No part of the consideration to be distributed by Distributing will be received by the Distributing shareholders as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (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 and Controlled each will continue the active conduct of its business, independently and with its separate employees.
- (d) The distribution of the stock of Controlled is carried out for the following corporate business purposes: (1) the expansion goals and required financing of the two businesses are becoming so divergent that efficient financing and operation requires that the businesses operate separately. The complete segregation of these businesses will improve the debt to equity ratio for Business F and enhance its borrowing capacity allowing for expansion, and (2) the nature of Business F subjects Business G to significant liabilities under state statutes. Furthermore, liability insurance is becoming increasingly difficult to maintain. Distributing cannot obtain insurance coverage for certain liabilities. Therefore, in order to protect Business G from these risks, Distributing has proposed to separate the two businesses. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (e) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (f) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities to be assumed (as determined under §357(d)) by Controlled.
- (g) The liabilities to be assumed (as determined under §357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.
- (h) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (i) 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.
- (j) No two parties to the transaction are investment companies as defined in §368(a) (2) (F) (iii) and (iv).
- (k) There is no acquisition of stock of Distributing or Controlled (including any predecessor or successor of any such corporation) that is part of a plan or series of related transactions (within the meaning of §1.355-7T) that includes the distribution of the Controlled stock.

- (l) Distributing is not an "S" corporation within the meaning of §1362(a), but immediately before the distribution, Distributing will be eligible to make an "S" corporation election pursuant to §1362(a). Controlled may elect to be an "S" corporation pursuant to §1362(a) on the first available date after the distribution.

Based solely on the information submitted and representations made, we hold as follows:

- (1) The transfer by Distributing of the Business G assets to Controlled in exchange for all of the issued and outstanding stock of Controlled and the assumption by Controlled of the liabilities associated with Business G, followed by the distribution of the stock of Controlled, as described above, will qualify as a reorganization under §368(a)(1)(D). Distributing and Controlled each will be a "party to a reorganization" under §368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of the Business G assets to Controlled in exchange for Controlled stock and the assumption of liabilities, as described above (§§361(a) and 357(a)).
- (3) Controlled will recognize no gain or loss on the receipt of the Business G assets in exchange for Controlled stock, as described above (§1032(a)).
- (4) Controlled's basis in each asset will be the same as the basis of such asset in the hands of Distributing immediately prior to the transfer (§362(b)).
- (5) Controlled's holding period for each asset received from Distributing will include the period during which Distributing held such asset (§1223(2)).
- (6) Distributing will recognize no gain or loss on the distribution of the Controlled stock (§361(c) (1)).
- (7) Distributing's shareholders will recognize no gain or loss (and no amount will be included in their income) upon their receipt of the Controlled stock, as described above (§355(a) (1)).
- (8) The aggregate basis of the Distributing and Controlled stock in the hands of the Distributing shareholders immediately after the distribution will equal the Distributing shareholders' aggregate basis in their Distributing stock immediately before the distribution, allocated in proportion to the fair market value of each in accordance with §1.358-2(a)(2) (§§358(a)(1), (b) and (c)).

- (9) The Distributing shareholders' holding period of the Controlled stock received in the distribution will include the holding period of the Distributing stock on which the distribution is made, provided that such Distributing stock is held by them as a capital asset on the date of the distribution (§1223(1)).
- (10) Earnings and profits will be allocated between Distributing and Controlled in accordance with §1.312-10(a).

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 transaction is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both; 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) provides that it may not be used or cited as precedent.

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

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

Sincerely,

Filiz A. Serbes
Chief, Branch 3
Office of Associate Chief Counsel (Corporate)

cc: