

Dear _____ :

This letter responds to your letter dated September 23, 2005 submitted on behalf of Distributing, requesting rulings as to certain federal income tax consequences of a proposed transaction. The following is a summary of the information in your letter and in subsequent letters dated September 27, 2005, October 21, 2005, October 24, 2005, November 7, 2005, November 29, 2005 and December 16, 2005.

The rulings contained in this letter are based upon facts and representations that you submitted on behalf of 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. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the transaction described below satisfies the business purpose requirement of section 1.355-2(b) of the Income Tax Regulations, whether the distribution described below is used principally as a device for the distribution of earnings and profits of Distributing or Controlled or both (see section 355(a)(1)(B) of the Internal Revenue Code and section 1.355-2(d)), or whether the distribution described below 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 fifty percent (50%) or greater interest in Distributing or Controlled (see sections 355(e) and 1.355-7). Moreover, no opinion is expressed on the validity of any subchapter S election of either Distributing or Controlled.

Distributing is an accrual method State X corporation. Distributing was incorporated on Date 1 and has been an S corporation since that time. Distributing has one class of stock issued and outstanding, all of which is collectively owned by Shareholders A, B and C ("Shareholders"). Distributing incorporated Controlled on Date 2 in State X. Controlled has outstanding one class of stock, all of which is owned by Distributing. Controlled elected treatment as a qualified subchapter S subsidiary ("QSub") on Date 2 and since that time has been treated as a disregarded entity under section 1.1361-4(a)(1).

Distributing has been engaged in each of Business A and Business B for more than five years. The financial information submitted by Distributing indicates that each of Business A and Business B has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past 5 years.

Business A involves the sale of products pursuant to an agreement with the Business A manufacturer. Distributing represents that the Business A manufacturer now requires all current and future sellers of the product to provide a facility that meets certain specifications and to form an exclusive legal entity with an exclusive Business A financial statement. Because Distributing currently sells products of both Business A and B, Distributing must separate Business A from Business B to comply with the Business A manufacturer's requirements. In order to achieve this goal, Distributing proposes to

separate Business A from Business B by transferring all assets and liabilities associated with Business A to Controlled and then distributing the stock of Controlled to the Shareholders pro rata (the "Distribution").

The parties have made the following representations concerning the proposed transaction:

(a) The total adjusted bases of the assets transferred to Controlled by Distributing equals or exceeds the sum of (a) the total liabilities assumed (within the meaning of section 357(d)) by Controlled and (b) the amount of any money and the fair market value of any other property (within the meaning of section 361(b)) received by Distributing and transferred to its creditors in connection with the reorganization. The liabilities assumed in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

(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 total fair market value of the assets transferred to Controlled by Distributing will exceed the sum of (a) the amount of liabilities assumed (within the meaning of section 357(d)) by Controlled in connection with the exchange, (b) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange and (c) the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 361(a) without the recognition of gain) received by Distributing in connection with the exchange. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.

(d) The total fair market value of the assets of Distributing transferred to Controlled will equal or exceed the aggregate adjusted basis of the transferred assets.

(e) There is no plan or intention to liquidate either Distributing or Controlled, 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.

(f) The five (5) years of financial information submitted on behalf of Distributing 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 submitted.

(g) Following the transaction, Controlled and Distributing will each continue the active conduct of Business A and Business B, respectively, independently and with its separate employees.

(h) The Distribution is being carried out for the following corporate business purpose: Distributing wishes to comply with the Business A manufacturer's requirement that dealerships engaged in the sale of Business A products operate through a separate legal entity which deals exclusively in Business A products. The Distribution is motivated, in whole or substantial part, by that corporate business purpose.

(i) Distributing is an S corporation (within the meaning of section 1361(a)). Controlled will elect to be an S corporation pursuant to section 1362(a) immediately after the Distribution and there is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

(j) The transaction is not being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

(k) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.

(m) 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.

(n) No two parties to the transaction are investment companies as defined in sections 368(a)(2)(F)(iii) and (iv).

(o) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing fifty percent (50%) or more of the total combined voting power of all classes of Distributing stock entitled to vote, or fifty percent (50%) or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in sections 355(d)(5) and (d)(8)) during the five (5) year period (determined after applying section 355(d)(6)) ending on the Distribution date.

(p) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing fifty percent (50%) or more of the total combined voting power of all classes of Controlled stock entitled to vote, or fifty percent (50%) or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five (5) year period (determined after applying section 355(d)(6)) ending on the Distribution date, or (ii) attributable to distributions on 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 Distribution date.

(q) 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 fifty percent (50%) or more of the total combined voting power of all classes of either Distributing or Controlled stock entitled to vote or stock possessing fifty percent (50%) or more of the total value of all classes of stock of either Distributing or Controlled.

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

(1) The Distribution will cause a termination of the QSub election of Controlled because Controlled will cease to be a wholly owned subsidiary of an S corporation. As a result, Controlled will be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the termination from Distributing in exchange for stock of Controlled. Section 1.1361-5(b)(1)(i).

(2) The deemed exchange of Distributing's Business A assets, subject to liabilities, for Controlled stock resulting from the termination of the QSub election, as set forth above, followed by the distribution of all of the Controlled stock to the Shareholders, will be treated as a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" within the meaning of section 368(b).

(3) Distributing will recognize no gain or loss upon the deemed exchange of its Business A assets for Controlled common stock and the assumption of liabilities associated with the transferred assets. Sections 357(a) and 361(a).

(4) Controlled will recognize no gain or loss upon the deemed exchange of Distributing's Business A assets, subject to liabilities, for Controlled common stock. Section 1032(a).

(5) The basis of each asset received by Controlled in the deemed exchange of Distributing's Business A assets for Controlled common stock will equal the basis of such asset in the hands of Distributing immediately prior to the transaction. Section 362(b).

(6) Controlled's holding period for each asset received in the deemed exchange of Distributing's Business A assets for Controlled common stock will include the period during which such asset was held by Distributing. Section 1223(2).

(7) Distributing will recognize no gain or loss on the distribution of Controlled stock to the Shareholders. Section 361(c)(1).

(8) The Shareholders will recognize no gain or loss (and no amount will be included in income) upon the receipt of the Controlled stock in the Distribution. Section 355(a)(1).

(9) The aggregate basis of the Distributing and Controlled stock in the hands of the Shareholders will equal the aggregate basis of the Distributing stock held by the

Shareholders immediately before the Distribution, allocated between the Distributing stock and the Controlled stock in proportion to the relative fair market value of each in accordance with section 1.358-2(a)(2). Section 358(a)(1),(b) and (c).

(10) The holding period of Controlled stock received by the Shareholders in the Distribution will include the holding period of the Distributing stock with respect to which the Distribution will be made, provided that such Shareholders hold the Distributing stock as a capital asset on the date of the Distribution. Section 1223(1).

(11) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under section 386(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under section 1361, Controlled will be eligible to make a subchapter S election under section 1362(a) for its first taxable year, provided such election is made effective immediately following the termination of the original QSub election.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Moreover, no opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Internal Revenue Code or Income Tax 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 (as provided above), no opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of section 1.355-2(b); (ii) whether the Distribution is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see sections 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 section 355(e)(2)(A)(ii). Finally, no opinion is expressed on the validity of any subchapter S election of either Distributing or Controlled.

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.

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

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

Sincerely,

Lisa A. Fuller
Senior Counsel, Branch 1
Office of Associate Chief Counsel (Corporate)

cc: