

Business 1 =

Business 2 =

Dear :

We respond to your letter dated March 16, 2004, requesting rulings concerning the Federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated May 25, June 9, June 21, July 9, and July 28, 2004. 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 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 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).

Parent, a publicly traded State X corporation is the common parent of an affiliated group of corporations that files a consolidated Federal income tax return. Parent owns all the stock of Distributing. Distributing owns all the stock of Controlled. Shareholder 1, Shareholder 2, Shareholder 3 and Shareholder 4 together own less than 50 percent of Parent stock, and have each held their respective shares of Parent stock for over five years.

We have received information that Business 1 (currently conducted through Distributing) and Business 2 (currently conducted through Controlled) each have had gross receipts and operating expenses representative of an active trade or business for each of the past five years.

For what has been represented as a valid business purpose, the taxpayers have proposed the following transaction:

- (i) Distributing will distribute the outstanding shares of Controlled to Parent (the "First Distribution").
- (ii) Controlled will form a single member limited liability company ("LLC") and contribute assets relating to Business 2 conducted in State X to LLC in exchange for all of LLC's member interests and the assumption by LLC of the liabilities related to those assets. Controlled will treat LLC as disregarded as an entity separate from its owner for Federal income tax purposes under § 301.7701-3.
- (iii) Controlled will distribute LLC to Parent (the "Second Distribution").
- (iv) Parent will distribute all the Controlled stock to Shareholder 1, Shareholder 2, Shareholder 3 and Shareholder 4 in exchange for Parent stock of equal value (the "Third Distribution").

The taxpayers have made the following representations in connection with the First Distribution:

- (a) No part of the Controlled stock to be distributed by Distributing will be received by Parent 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 and Controlled represents the corporations' present operations. There have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the First Distribution, Distributing and Controlled will each continue the active conduct of its respective business, independently and with its separate employees.
- (d) The First Distribution is being carried out to facilitate the Third Distribution. The distribution of stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (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 First Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7T) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (g) No intercorporate debt will exist between Distributing or Controlled at the time of, or subsequent to, the First Distribution.
- (h) Immediately before the First Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. No member of the group has an excess loss account in the stock of Controlled or any of its subsidiaries.
- (i) Payments made in connection with all continuing transactions, if any, between Distributing and its subsidiaries and Controlled and its subsidiaries (if any), will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

The taxpayers have made the following representations in connection with the Second Distribution:

- (a) Controlled will treat LLC as disregarded as an entity separate from its owner for Federal tax purposes under § 301.7701-3.
- (b) Following the Second Distribution, Parent will treat LLC as disregarded as an entity separate from its owner for Federal tax purposes under § 301.7701-3.

The taxpayers have made the following representations in connection with the Third Distribution:

- (a) The fair market value of Controlled stock to be received by Shareholder 1, Shareholder 2, Shareholder 3 and Shareholder 4 will be approximately equal to the fair market value of Parent stock surrendered by Shareholder 1, Shareholder 2, Shareholder 3 and Shareholder 4 in the exchange.
- (b) No part of the Controlled stock to be distributed by Parent will be received by Shareholder 1, Shareholder 2, Shareholder 3 or Shareholder 4 as a creditor, employee or in any other capacity other than that of a shareholder of Parent.

- (c) The five years of financial information submitted on behalf of Parent and Controlled represents the corporations' present operations. There have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the Third Distribution, Parent and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of Business 2.
- (e) The Third Distribution is carried out for the following corporate business purposes: to allow Parent and Controlled to focus on their separate operations of Business 2 and remove hindrances which were effecting the overall management of Business 2. The distribution of stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) The transaction is not used principally as a device for the distribution of the earnings and profits of Parent or Controlled or both.
- (g) The Third Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7T) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Parent or Controlled (including any predecessor or successor of any such corporation).
- (h) No intercorporate debt will exist between Parent and Controlled at the time of, or subsequent to, the Third Distribution.
- (i) Immediately before the Third Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. No member of the group has an excess loss account in the stock of Controlled or any of its subsidiaries.
- (j) Payments made in connection with all continuing transactions, if any, between Parent and its subsidiaries, and Controlled and its subsidiaries (if any) will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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

- (1) Distributing will recognize no gain or loss upon the First Distribution (§ 355(c)).

- (2) Parent will recognize no gain or loss and no amount will be included in its income upon the receipt of the Controlled stock (§ 355(a)(1)).
- (3) The holding period of the Controlled stock received by Parent will include the holding period of the Distributing stock on which the First Distribution will be made, provided Parent holds the Distributing stock as a capital asset on the date of the First Distribution (§1223(1)).
- (4) Earnings and profits will be allocated between Distributing and Controlled in accordance with §§ 1.312-10(b) and 1.1502-33.

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

- (1) For Federal income tax purposes, steps (ii) and (iii), above, will be treated as if Controlled distributed assets relating to Business 2 conducted in State X to Parent.
- (2) No amount will be included in the gross income of Parent upon the distribution (§1.1502-13(f)(2)(ii)). The amount of the distribution will constitute a negative adjustment to its basis in Controlled stock (§1.1502-32(b)(2)(iv)).
- (3) Gain or loss will be recognized by Controlled on the Second Distribution, and will be taken into account as described immediately below (§§ 311(b) and 1.1502-13(f)(2)(iii)).

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

- (1) Immediately before the Third Distribution, Controlled will take into account and recognize the gain or loss, if any, recognized on the Second Distribution (§§ 267(f), and 1.1502-13(d)(1)(i)(A)).
- (2) Parent will recognize no gain or loss upon the Third Distribution (§ 355(c)).
- (3) Shareholder 1, Shareholder 2, Shareholder 3 and Shareholder 4 will recognize no gain or loss and no amount will be included in their income upon the receipt of the Controlled stock (§ 355(a)(1)).
- (4) The aggregate basis of the Parent and Controlled stock held by Shareholder 1, Shareholder 2, Shareholder 3 and Shareholder 4 immediately after the Third Distribution will equal the basis of the Parent stock held by Shareholder 1, Shareholder 2, Shareholder 3 and

Shareholder 4, respectively, immediately before the Third Distribution, allocated in the proportion to the fair market value of the Parent and Controlled stock in accordance with § 1.358-2(a)(2) (§ 358(a), (b), and (c)).

- (5) The holding period of the Controlled stock received by Shareholder 1, Shareholder 2, Shareholder 3 and Shareholder 4 will include the holding period of the Parent stock on which the Third Distribution will be made, provided Shareholder 1, Shareholder 2, Shareholder 3 and Shareholder 4 hold the Parent stock as a capital asset on the date of the Third Distribution (§1223(1)).
- (6) Earnings and profits will be allocated between Parent and Controlled in accordance with §§ 1.312-10(b) and 1.1502-33.

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 First Distribution or the Third Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the proposed transactions are used principally as a device for the distribution of the earnings and profits of Parent, Distributing or Controlled (see § 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the First Distribution or Third 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(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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

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,

Ken Cohen
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Corporate)