

**Internal Revenue Service**

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Date:

August 06, 2004

In Re:

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Shareholder F =

Business G =

Business H =

a =

b =

c =

d =

e =

Key Employee =

LLC =

Dear :

This is in response to a letter dated April 2, 2004, submitted on behalf of Distributing, requesting rulings under §§ 355 and 368 of the Internal Revenue Code (the "Code") with respect to a proposed transaction. Additional information was received in letters dated June 3, July 1, and August 6, 2004.

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)), 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 corporation or the controlled corporation (see § 355(e)(2)(A)(ii) and § 1.355-7T).

Distributing is a calendar year corporation engaged in Business G and Business H. Distributing has supplied information indicating that each of Business G and Business H have had gross receipts and operating expenses representing the active conduct of a trade of business for each of the past five years. Distributing has outstanding two classes of stock. The non-voting common stock is held as follows:

Shareholder A (a%), Shareholder B (b%), Shareholder C (b%), Shareholder D (b%), and Shareholder E (b%). The voting preferred stock is held as follows: Shareholder A (d%) and Shareholder F (c%).

For what are represented to be valid business purposes, Distributing proposes the following transaction (the "Proposed Transaction"):

- (i) Distributing will form Controlled and will contribute the assets and liabilities of Business H to Controlled in exchange for all of the issued and outstanding shares of Controlled stock (the "Contribution").
- (ii) Distributing will distribute all of the outstanding stock of Controlled to the shareholders of Controlled on a pro rata basis (the "Distribution").
- (iii) Key Employee will acquire an equity interest in Distributing consisting of e% of Distributing's capital stock.

Following the Proposed Transaction, the shareholders of Controlled will organize LLC and LLC will make an election pursuant to § 301.7701-3(c) to be taxed as a corporation for federal income tax purposes. Controlled will merge into LLC (the "Merger").

The following representations have been made with respect to the Proposed Transaction:

(a) 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 as a shareholder of Distributing.

(b) The five 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.

(c) Following the Distribution, 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: (i) to provide employee with an equity interest and (ii) to reduce costs. The Distribution is motivated, in whole or substantial part, by these corporate business purposes.

(e) The Proposed 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 basis and fair market value of the assets transferred to Controlled by Distributing in connection with the Contribution each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject (as determined under § 357(d)). The liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

(g) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.

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

(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 Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(k) There is no acquisition of Distributing or Controlled stock (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 Controlled stock.

(l) The Distribution will not be a disqualified distribution (as defined in § 355(d)(2)) because immediately after the Distribution: (i) no person (determined after applying § 355(d)(7)) will hold disqualified stock (defined in § 355(d)(3)) in Distributing that will constitute a 50 percent or greater interest (defined in § 355(d)(4)) in Distributing, and (ii) no person (determined after applying § 355(d)(7)) will hold disqualified stock (defined in § 355(d)(3)) in Controlled that will constitute a 50 percent or greater interest (defined in § 355(d)(4)) in Controlled.

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

(1) The Contribution, followed by the Distribution will constitute a reorganization within the meaning of § 368(a)(1)(D) of the Code. Distributing and Controlled each will be "a party to a reorganization" within the meaning of § 368(b) of the Code.

(2) No gain or loss will be recognized by Distributing on the Contribution (§§ 357(a) and 361(a)).

(3) No gain or loss will be recognized by Controlled on the Contribution (§§ 1032(a) and 357(a)).

(4) Controlled's basis in each asset received in the Contribution will equal the basis of such asset in the hands of Distributing immediately prior to the Proposed Transaction (§ 362(b)).

(5) Controlled's holding period for each asset received in the Contribution will include the period during which such asset was held by Distributing (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing upon the Distribution (§ 361(c)).

(7) No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing upon receipt of the Controlled stock in the Distribution (§ 355(a)).

(8) The aggregate basis of the Distributing and Controlled stock in the hands of a Distributing shareholder will equal such shareholder's basis in the Distributing stock held immediately before the Distribution, allocated between the Distributing stock and the Controlled stock in proportion to the relative fair market value of each immediately following the Distribution in accordance with § 1.358-2(a)(2) (§ 358(a)(1) and (b)).

(9) The holding period of the Controlled stock received by a Distributing shareholder will include the holding period of the Distributing stock on which the Distribution is made, provided that such Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a).

The rulings contained in this letter are based on 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 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.

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the 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, no opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether 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 (see § 355(a)(1)(B) and § 1.355-2(d));

and (iii) whether the Distribution and any acquisition or acquisitions of the stock of Controlled or Distributing are not part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii). Also, no opinion is expressed regarding the tax status of LLC as a disregarded entity under § 301.7701-3 and the federal income tax consequences of the Merger.

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 in this office, a copy of this ruling letter will be forwarded to the taxpayer and another representative.

Sincerely yours,  
Associate Chief Counsel (Corporate)

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Lisa A. Fuller  
Assistant to Chief, Branch 1

cc: