

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

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In Re:

Refer Reply To:

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Date:

March 05, 2004

Legend:

Distributing =
Controlled =
State X =
Date 1 =
Business A =
Business B =

Dear

This letter responds to your November 7, 2003 request for rulings submitted on behalf of Distributing regarding certain federal income tax consequences of a proposed transaction. Additional information was received in letters dated December 29, 2003 and February 18, 2004. The information submitted in the November 7, 2003 request and in the later correspondence is summarized below.

Distributing was incorporated on Date 1 in State X. Distributing has one class of stock which is owned equally by two shareholders. Distributing is engaged in two unrelated businesses: Business A and Business B. Distributing has supplied financial information indicating that both Business A and Business B have had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing has represented that for valid business reasons, primarily, risk reduction, Business A and Business B should be separated. To effect the separation, Distributing proposes the following transaction: Distributing will form a new corporation, Controlled, and will contribute to Controlled the assets of Business B. Distributing will distribute all of the stock of Controlled equally to both shareholders of Distributing.

In connection with the proposed transaction, Distributing made the following representations:

- a) No part of the consideration distributed by Distributing will be received by any shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

- 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 will each 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 business purpose: risk reduction. The distribution of the 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 or profits of Distributing or Controlled.
- f) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing in the transaction will each equal or exceed the sum of liabilities assumed (as determined under section 357(d)) by Controlled, plus any liabilities to which the transferred assets are subject.
- g) The liabilities assumed and the liabilities to which the transferred assets are subject (as determined under section 357(d)) in the transaction above were incurred in the ordinary course of business and are associated with the assets being transferred.
- h) Distributing neither accumulated its receivables, nor made extraordinary payment of its payables in anticipation of the transaction.
- i) No two parties to the transactions are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- j) 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.
- k) 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) on the first available date after the distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.
- l) The distributions are not part of a plan or series of related transactions (within the meaning section 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 section 355(d)(4)) in Distributing or Controlled (including any predecessor or successor).
- m) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote or 50 percent 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-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions of 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 date of the Distribution.

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

1. The transfer of the Distributing assets to Controlled in exchange for all of the stock of Controlled, followed by the distribution of the stock of Controlled to the shareholders of Distributing will be a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled will each be "a party to the reorganization" within the meaning of section 368(b) of the Code.
2. Distributing will recognize no gain or loss on the transfer of the assets to Controlled in exchange for the stock of Controlled and Controlled's assumption of related liabilities. (Section 361(a) and 357(a)).
3. Controlled will recognize no gain or loss on its receipt of the transferred assets and its assumption of related liabilities from Distributing in exchange for its stock. (Section 1032(a) and 357(a)).
4. The basis of the assets received by Controlled will be the same as the basis of the assets in the hands of Distributing immediately prior to the transaction. (Section 362(b)).
5. The holding period of the assets transferred to Controlled will include the period during which such assets were held by Distributing. (Section 1223(2)).
6. 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 stock of Controlled. (Section 355(a)).
7. The aggregate basis of the Distributing and Controlled stock in the hands of each shareholder will equal the aggregate basis of the Distributing stock held immediately before the distribution, allocated between the Distributing and Controlled stock in proportion to the relative fair market value of each immediately following the distribution. (Section 358(b)).
8. The holding period of the Controlled stock received by a Distributing shareholder will include the holding period of the Distributing stock with respect to which the distribution will be made, provided that the Distributing stock is held as a capital asset on the date of exchange. (Section 1223(1)).
9. No gain or loss will be recognized by Distributing on its distribution of all its Controlled stock. (Section 361(c)).

10. A proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with section 312(h) of the Code and 1.312-10(a) of the Income Tax Regulations.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. Although this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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 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; 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).

This ruling is directed only to the taxpayer 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 taxpayer.

Sincerely,

Steven J. Hankin

Steven J. Hankin
Senior Technical Reviewer, Branch 6
Office of Associate Chief Counsel
(Corporate)

cc: