

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200437029**

Release Date: 9/10/04

Index Numbers: 355.01-01; 368.04-00

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CC:CORP:B04 – PLR-171508-03

Date:

April 20, 2004

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Business A =

Business B =

Date 1 =

a =

b =

c =

d =

e =

Dear

This letter responds to your November 26, 2003 request for rulings regarding certain Federal income tax consequences of a partially completed and proposed transaction. The information submitted in that request and in later correspondence 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)), 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).

Summary of Facts

Distributing is the common parent of an affiliated group of corporations that files a consolidated Federal income tax return. Distributing has one class of common stock outstanding. Shareholder A owns a percent and Shareholder B owns b percent. None of the remaining c shareholders own more than d percent of Distributing's outstanding stock. Distributing is engaged in Business A and Business B.

Financial information submitted by Distributing indicates that Business A and Business B each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

For what has been represented to be valid business reasons, Distributing has proposed and partially completed the following transaction (the "Proposed Transaction"):

- (i) On Date 1, Distributing contributed all of the assets and liabilities associated with Business B to newly formed Controlled in exchange for all of Controlled's outstanding stock and the assumption by Controlled of related liabilities (the "Contribution").

- (ii) Distributing will distribute all of its Controlled stock to Shareholder A and Shareholder B in exchange for Distributing stock of equal value (the "Distribution").

Following the transaction, Shareholder A and Shareholder B will collectively own an e percent interest in Distributing.

Representations

The following representations have been made regarding the Proposed Transaction:

- (a) The fair market value of the Controlled stock received by Shareholder A and Shareholder B will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholders in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by Shareholder A or Shareholder B as a creditor, employee, or in any capacity other than that of a Distributing shareholder.
- (c) The five years of financial information submitted on behalf of Distributing is representative of its present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the Proposed Transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (e) The Distribution is being carried out for the following corporate business purposes: To give control of Business A to the responsible shareholders; to enhance the borrowing capacity of Business A; and to divide the risks of Business A from Business B. The Distribution is motivated in whole or substantial part by one or more of these corporate business purposes.
- (f) The Proposed Transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (g) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing in the Contribution will, in each instance, equal or exceed the liabilities assumed (as determined under § 357(d)) by Controlled. The liabilities assumed (as determined under § 357(d)) in the Contribution 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 Proposed Transaction.
- (i) No intercorporate debt will exist between Distributing and Controlled at the time of or after the Distribution.
- (j) Immediately before the Proposed Transaction, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Further, any excess loss account Distributing may have with respect to the Controlled stock will be included in income immediately before the distribution (see § 1.1502-19).
- (k) 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.
- (l) No two parties to the transaction are investment companies as defined in §§ 368(a)(2)(F)(iii) and (iv).
- (m) 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 Controlled stock.
- (n) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (o) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 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 § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

Rulings

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

- (1) The Contribution, followed by the Distribution, will qualify as a reorganization under § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" under § 368(b).
- (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)).
- (4) The basis that Controlled has in each asset received from Distributing will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).
- (5) The holding period for each asset received by Controlled in the Contribution will include the period during which Distributing held that asset (§ 1223(2)).
- (6) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Shareholder A and Shareholder B upon their receipt of the Controlled stock in exchange for their Distributing stock (§ 355(a)(1)).
- (7) The aggregate basis of the Controlled stock in the hands of Shareholder A and Shareholder B after the Distribution will, in each instance, equal the aggregate basis of the respective Distributing stock surrendered by each shareholder in the exchange (§ 358(a)(1)).
- (8) The holding period of the Controlled stock received by Shareholder A and Shareholder B will, in each instance, include the holding period of the respective Distributing stock surrendered by each shareholder, provided such stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (9) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)).
- (10) As provided in § 312(h), proper allocation of earnings and profits will be made between Distributing and Controlled in accordance with § 1.312-10(a).

Caveats

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 used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see § 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 § 355(e)(2)(A)(ii).

Procedural Statements

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.

Each taxpayer involved in this transaction should attach a copy of this ruling letter to the taxpayer's Federal income tax return for the taxable year in which the Proposed Transaction is completed.

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

Sincerely,

Richard K. Passales

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Corporate)

cc: