

**Internal Revenue Service**

Number: **200514005**

Release Date: 4/8/2005

Index Number: 355.00-00, 367.00-00,  
368.04-00

Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

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CC:CORP:B05  
PLR-153330-04

Date:  
December 06, 2004

In Re:

Distributing =

Controlled =

Individual =

Contributor =

Business A =

Business B =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Building =

Owners =

LLC 1 =

LLC 2 =

LLC 3 =

LLC 4 =

LLC 5 =

LLC 6 =

LLC 7 =

a =

b

c =

d =

e =

Dear :

This letter responds to your September 24, 2004 request for rulings on certain federal income tax consequences of the Proposed Transactions (defined below). The information provided in that request and 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 Distribution (defined below): (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 or 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 or controlled corporation (see § 355(e)(2)(A)(ii) and § 1.355-7T).

### **Summary of Facts**

Distributing is the common parent of an affiliated group whose includible corporations join in filing a consolidated federal income tax return (the "Distributing Group"). Distributing has one class of common stock outstanding, more than a percent of which is held by domestic and foreign trusts for the benefit of various lineal descendants of Individual. Distributing conducts all of its business operations through subsidiaries, including LLC 1, a limited liability company of which Distributing is the sole member. LLC 1 is an entity that is disregarded as separate from its owner for federal tax purposes under § 301.7701-3 of the Procedure and Administrative Regulations (a "disregarded entity"). LLC 1 is engaged, directly and indirectly, in the conduct of Business A.

Distributing is also the sole member of LLC 2, a disregarded entity that is engaged in the conduct of Business B through its direct and indirect subsidiaries. LLC 2 wholly owns Sub 1, Sub 3, and Sub 4; Sub 1 wholly owns Sub 2; and Sub 4 wholly owns Sub 5.

LLC 1 leases Building for use as its corporate headquarters from Owners, who own Building as tenants in common. Each Owner is treated as a disregarded entity or partnership for federal tax purposes. Before step (i) of the Proposed Transactions, Contributor, a limited liability company, will acquire all of the equity interests in each Owner in exchange for membership interests in Contributor. Following these exchanges, for federal tax purposes, Contributor will be treated as a partnership, each Owner will be treated as a disregarded entity, and Contributor will be treated as the direct owner of Building.

Financial information submitted by Distributing indicates that Business A (as conducted by Distributing through LLC 1) and Business B (as conducted by Sub 1, Sub 2, Sub 3, Sub 4, and Sub 5) each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Business A operates in a highly competitive industry in which a limited number of skilled employees are actively recruited with lucrative compensation packages that generally (except in the case of Business A) include an equity component. The Distributing board of directors has been advised that Business A will be unable to attract and retain the highly skilled employees it needs without offering them a meaningful equity stake in the business, and that such a stake could best be achieved if Business A were separated from the Distributing Group. The Distributing board of directors has also been advised that the value of Business A would be enhanced by its separation from the Distributing Group. This enhanced value would enable the management of Business A to more efficiently pursue the growth plans that are critical to its continued success. Based on this advice and other information, the Distributing board has decided to separate Business A from the Distributing Group (the "Separation").

## Proposed Transactions

To effect the Separation, Distributing has proposed the following series of transactions (the "Proposed Transactions"):

(i) Distributing will contribute to newly formed Controlled (a) all of the membership interests in LLC 1, (b) b dollars in cash, and (c) a short-term promissory note having a principal amount of c dollars and bearing a market rate of interest (the "Contributed Note") solely in exchange for Controlled stock (the "Incorporation"). The cash and Contributed Note will be used to fund working capital and general corporate needs. Pursuant to the same plan, Contributor will transfer all of the membership interests in each of the Owners to Controlled solely in exchange for Controlled stock (the "Contribution"). For federal tax purposes, the contribution by Distributing of the membership interests in LLC 1 will be treated as a contribution of the assets held by LLC 1, and the Contribution will be treated as a transfer by Contributor of the Building. Following step (i), Controlled will be owned d (more than 80) percent by Distributing and e percent by Contributor.

(ii) Sub 1 will convert under applicable state law into a limited liability company, LLC 3, whose sole member is LLC 2.

(iii) Sub 2 will convert under applicable state law into a limited liability company, LLC 4, whose sole member is LLC 3.

(iv) Sub 3 will convert under applicable state law into a limited liability company, LLC 5, whose sole member is LLC 2.

(v) Sub 4 will convert under applicable state law into a limited liability company, LLC 6, whose sole member is LLC 2.

(vi) Sub 5 will convert under applicable state law into a limited liability company, LLC 7, whose sole member is LLC 6.

(vii) Distributing will distribute all of the Controlled stock that it owns to its stockholders, pro rata (the "Distribution").

Each of LLC 2, LLC 3, LLC 4, LLC 5, LLC 6, and LLC 7 will be treated as a disregarded entity for federal tax purposes. Distributing and Controlled will enter into a Tax Separation Agreement in connection with the Proposed Transactions.

## Representations

### The Contribution

Contributor makes the following representations regarding the Contribution described above in step (i):

(a) No stock or securities will be issued to Contributor for services rendered to or for the benefit of Controlled in connection with the proposed transaction. No stock or securities will be issued to Contributor for indebtedness of Controlled that is not evidenced by a security or for interest on indebtedness of Controlled that accrued on or after the beginning of the holding period of Contributor for the debt.

(b) The transfer of the Building by Contributor to Controlled is not the result of the solicitation by a promoter, broker, or investment house.

(c) Contributor will not retain any rights in the property transferred to Controlled.

(d) The adjusted basis and the fair market value of the assets transferred by Contributor to Controlled will, in each instance, equal or exceed the sum of the liabilities assumed (as determined under § 357(d)) by Controlled.

(e) The liabilities of Contributor assumed (as determined under § 357(d)) by Controlled will have been incurred in the ordinary course of business and will be associated with the transferred assets.

(f) There is no indebtedness between Controlled and Contributor and there will be no indebtedness created in favor of Contributor as a result of the transaction.

(g) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.

(h) All exchanges will occur on approximately the same date.

(i) There is no plan or intention on the part of Controlled to redeem or otherwise reacquire any stock or indebtedness issued to Contributor in the proposed transaction.

(j) Taking into account any issuance of additional shares of Controlled stock; any issuance of stock for services; the exercise of any Controlled stock rights, warrants, or subscriptions; a public offering of Controlled stock; and the sale, exchange, transfer by gift, or other disposition of any of the Controlled stock received in the exchange, Contributor and Distributing will be in "control" of Controlled within the meaning of § 368(c).

(k) Each of Contributor and Distributing will receive stock, securities, or other property approximately equal to the fair market value of the property transferred to Controlled.

(l) Controlled will remain in existence and retain and use the property transferred to it in a trade or business.

(m) There is no plan or intention by Controlled to dispose of the transferred property other than in the normal course of business operations.

(n) Each party to the Contribution will pay its or his/her own expenses, if any, incurred in connection with the Contribution.

(o) Controlled will not be an investment company within the meaning of § 351(e)(1) and § 1.351-1(c)(1)(ii).

(p) Contributor is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of § 368(a)(3)(A)), and the stock or securities received in the exchange will not be used to satisfy the indebtedness of such debtor.

(q) Controlled will not be a “personal service corporation” within the meaning of § 269A.

### The Incorporation and Distribution

Distributing makes the following representations regarding the Incorporation and Distribution described in steps (i) and (vii) above:

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

(s) The five years of financial information submitted on behalf of Business A (as directly conducted by LLC 1) and Business B (as directly conducted by each of Sub 1, Sub 2, Sub 3, Sub 4, and Sub 5) represents the present operation of each, and regarding each business, there have been no substantial operational changes since the date of the last financial statements submitted.

(t) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.

(u) The Distribution is carried out to enhance the value of Controlled stock for use in compensating key employees and funding growth. The Distribution is motivated, in whole or substantial part, by one or both of these corporate business purposes.

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

(w) 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 Distribution, except in the ordinary course of business.

(x) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (as determined under § 357(d)) by Controlled; and the liabilities assumed (as determined under § 357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

(y) Except for the Contributed Note and the final settlement of intercompany accounts, no intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.

(z) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (see § 1.1502-13 and § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). At the time of the Distribution, Distributing will not have an excess loss account in the Controlled stock (see § 1.1502-19).

(aa) Payments made in connection with any continuing transactions 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.

(bb) Neither Distributing nor Controlled is an investment company as defined in §§ 368(a)(2)(F)(iii) and (iv).

(cc) Distributing will not have been a United States real property holding corporation (as defined in § 897(c)(2)) at any time during the five-year period ending on the date of the Distribution.

(dd) The 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).

(ee) 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.

(ff) 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 (a) 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 (b) 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

### The Contribution

(1) No gain or loss will be recognized by Contributor on the Contribution (§ 351(a); *cf.* Rev. Rul. 76-123, 1976-1 C.B. 94; Rev. Rul. 68-357, 1968-2 C.B. 144).

(2) No gain or loss will be recognized by Controlled on the Contribution (§ 1032).

(3) The basis of Controlled in Building will equal the basis of Building in the hands of Contributor immediately before the Contribution (§ 362(a)).

(4) The holding period of Controlled in Building will include the period during which Building was held by Contributor (§ 1223(2)).

(5) The basis of the Controlled stock received by Contributor will equal Contributor's basis in Building immediately before the Contribution (§ 358(a)).

(6) The holding period of the Controlled stock received by Contributor will include the holding period of Contributor in Building immediately before the Contribution, provided that Building was either a capital asset as defined in § 1221 or property described in § 1231 (§ 1223(1)).

### The Incorporation and Distribution

(7) The Incorporation, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled will each be a "party to the reorganization" under § 368(b).

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

(9) No gain or loss will be recognized by Controlled on the Incorporation (§ 1032(a)).

(10) The basis of Controlled in each asset received in the Incorporation will equal the basis of that asset in the hands of Distributing immediately before the Incorporation (§ 362(b)).

(11) The holding period of Controlled for each asset received in the Incorporation will include the period during which that asset was held by Distributing (§ 1223(2)).

(12) No gain or loss will be recognized by (and no amount will be included in the income of) Distributing or the stockholders of Distributing on the Distribution (§§ 361(c)(1), 355(a)(1), and 1.367(e)-1(c)).

(13) The aggregate basis of the common stock of Distributing and Controlled held by each stockholder of Distributing immediately after the Distribution will equal the aggregate basis of the Distributing common stock held by such stockholder immediately before the Distribution, allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2). (§§ 358(a), (b), and (c)).

(14) The holding period of the Controlled stock received by each stockholder of Distributing will include the holding period of the Distributing common stock on which the Distribution is made, provided the stockholder held the Distributing stock as a capital asset on the date of the Distribution (§ 1223(1)).

(15) Earnings and profits, if any, will be allocated between Distributing and Controlled in accordance with §§ 312(h), 1.312-10(a), and 1.1502-33(e)(3).

(16) Payments made between any of Distributing, Controlled, or their respective subsidiaries under the Tax Separation Agreement to be entered into by Distributing and Controlled in connection with the Distribution regarding tax liabilities (i) that have arisen or will arise for a taxable period ending on or before the date of the Distribution or for a taxable period beginning before and ending after the Distribution, and (ii) that will not become fixed or ascertainable until after the Distribution, will be treated as occurring immediately before the Distribution.

### **Caveats**

No opinion is expressed about the treatment of the Proposed Transactions under other provisions of the Code and regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, such Proposed Transactions 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 Distribution 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));

(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); or

(iv) Treatment of the conversions of Sub 1, Sub 2, Sub 3, Sub 4, and Sub 5 described above in steps (ii) through (vi).

### **Procedural Statements**

This ruling letter is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this ruling letter must be attached to the federal income tax return of each taxpayer involved in the Proposed Transactions for the taxable year in which the Proposed Transactions are completed.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to each of Distributing and Contributor.

Sincerely yours,

Associate Chief Counsel  
(Corporate)

By: Wayne T. Murray

Wayne T. Murray  
Special Counsel to the  
Associate Chief Counsel