

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. 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 section 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 section 355(a)(1)(B) of the Internal Revenue Code and section 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 section 355(e)(2)(A)(ii) and section 1.355-7).

Summary of Facts

Taxpayer is the common parent of an affiliated group whose includible corporations join in filing a consolidated federal income tax return (the "Taxpayer Group"). Taxpayer owns all the outstanding stock of Parent, and Parent owns all the outstanding stock of Distributing. Distributing is engaged in Business A and Business B and has incorporated Controlled to facilitate the proposed transaction.

Financial information has been received indicating 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.

Business A and Business B function in different industries, and Distributing management must attend to both. This puts Business A at a competitive disadvantage because its major competitors have management teams that are able to concentrate solely on Business A operations. Further, Business B has potential exposure to substantial environmental cleanup liabilities that has prevented Business A from securing long-term relationships with its suppliers. Taxpayer and Distributing, in consultation with their advisors, have decided that these problems may be remedied by the proposed transaction described below.

Proposed Transaction

Distributing has proposed the following transaction (the "Transaction"):

- (i) Distributing will contribute all of the assets associated with Business A to Controlled in exchange for all the stock of Controlled and the assumption by Controlled of liabilities associated with Business A (the "Contribution").

- (ii) Distributing will distribute all the stock of Controlled to Parent (the "Distribution").

Representations

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

- (a) The indebtedness owed by Controlled to Distributing, if any, after the Distribution will not constitute stock or securities.
- (b) No part of the consideration distributed by Distributing will be received by Parent as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Business A and Business B conducted by Distributing is representative of the present operations of each business, and there have been no substantial operational changes in either business since the date of the last financial statement submitted.
- (d) Following the Distribution, Distributing and Controlled each will continue the active conduct of its business, independently and with its separate employees.
- (e) The Distribution will be carried out for the following corporate business purposes: (i) to increase the ability of Business A to compete in its industry; (ii) to separate Business A from the environmental liabilities associated with Business B; (iii) to enhance the relationships of Business A with its raw material suppliers; and (iv) to increase the access of Business A to capital markets and alternative financing. The Distribution is motivated, in whole or in substantial part, by one or more of these corporate business purposes.
- (f) The Transaction is not being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (g) The total adjusted bases and the fair market value of Business A assets transferred to Controlled in the Contribution each will equal or exceed the sum of: (i) the total liabilities to be assumed (within the meaning of section 357(d)) by Controlled and (ii) the total amount of any money and the fair market value of any other property (within the meaning of section 361(b)) received by Distributing from Controlled and transferred to Distributing's creditors in connection with the reorganization.

- (h) The liabilities to be assumed (as determined under section 357(d)) by Controlled in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- (i) 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.
- (j) The total fair market value of the assets transferred to Controlled in the Contribution will exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of section 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 361(a) without the recognition of gain) received by Distributing in connection with the exchange. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
- (k) Distributing will neither accumulate its receivables nor make extraordinary payment of its payables in anticipation of the Distribution.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.
- (m) 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 section 1.1502-13 and section 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; section 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 stock of Controlled.
- (n) 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.
- (o) No two parties to the Transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (p) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 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 section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

- (q) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying 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 section 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 on Distributing stock or securities that were acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

The Distribution is not part of a plan or series of related transactions (within the meaning of section 1.355-7) 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 of any such corporation).

Rulings

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

- (1) The Contribution, followed by the Distribution, will be a reorganization under section 368(a)(1)(D). Distributing and Controlled will each be a “party to the reorganization” within the meaning of section 368(b).
- (2) No gain or loss will be recognized by Distributing on the Contribution (sections 361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled on the Contribution (section 1032(a)).
- (4) The basis of the property received by Controlled on the Contribution will equal the basis of the property in the hands of Distributing immediately before the Contribution (section 362(b)).

- (5) The holding period of the property received by Controlled on the Contribution will include the period during which Distributing held the property (section 1223(2)).
- (6) No gain or loss will be recognized by Distributing on the Distribution (section 361(c)(1)).
- (7) No gain or loss will be recognized by Parent on the Distribution (section 355(a)(1)).
- (8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of Parent after the Distribution will equal the aggregate basis of the Distributing stock held by Parent immediately before the Distribution, allocated between the stock of Distributing and Controlled in proportion to the fair market value of each immediately following the Distribution in accordance with section 1.358-1(a) (section 358(b) and (c)).
- (9) The holding period of the Controlled stock received by Parent on the Distribution will include the holding period of the Distributing stock on which the Distribution is made, provided the Distributing stock was held as a capital asset on the date of the Distribution (section 1223(1)).
- (10) Earnings and profits will be allocated between Distributing and Controlled in accordance with section 312(h) and sections 1.312-10(a) and 1.1502-33(f)(2).

Caveats

We express no opinion about the tax treatment of the Transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the Transaction that are not specifically covered by the above ruling. In particular, no opinion is expressed regarding:

- (i) Whether the Distribution satisfies the business purpose requirement of section 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 section 355(a)(1)(B) and section 1.355-2(d)); or
- (iii) Whether the Distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under section 355(e)(2)(A)(ii).

Procedural Statements

This ruling letter has no effect on any earlier documents and is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Each taxpayer involved in the transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the transaction covered by this letter is completed. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the Power of Attorney on file in this office, a copy of this letter ruling is being sent to your authorized representatives.

Sincerely,

Mark S. Jennings
Branch Chief, Branch 1
Office of Associate Chief Counsel (Corporate)