

Business X =

Business Y =

Dear :

This letter responds to your December 8, 2005 letter requesting rulings on certain federal income tax consequences of a proposed transaction. The information provided in that letter 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 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. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Distribution (defined below in step ii): (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)); 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 corporation or the controlled corporation (see § 355(e) and § 1.355-7).

Summary of Facts

Distributing is a calendar year corporation engaged in Business X and in Business Y. Distributing has four classes of stock outstanding. Shareholder A wholly owns each of the Class A, Class B and Class C stock. Shareholder B wholly owns the Class D stock. Financial information submitted by Distributing indicates that each of Business X and Business Y has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

For what is represented to be a valid business purpose, Distributing proposes the following transaction (the "Proposed Transaction"):

- (i) Distributing will form Controlled and contribute to Controlled all of the assets and liabilities used in connection with Business Y in exchange for all of the outstanding Controlled stock and the assumption by Controlled of

certain of the liabilities related to the transferred assets (the "Contribution").

- (ii) Distributing will distribute all of the Controlled stock to Shareholder A in exchange for \underline{x} shares of Distributing Class B stock held by Shareholder A equal to the fair market value of Business Y on the date of the distribution (the "Distribution").
- (iii) To facilitate the transition of Business Y to Controlled, for a period of not more than \underline{z} months, certain employees will perform services for both Distributing and Controlled and will be paid the fair market value of their services. Such expenditure shall be allocated between Distributing and Controlled on a pro-rata basis.
- (iv) Controlled will elect to be an S-Corporation pursuant to § 1362(a) on the first available date after the Distribution.

Representations

Distributing has made the following representations with respect to the Proposed Transaction:

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

(b) The fair market value of the Controlled stock to be received by Shareholder A will be approximately equal to the fair market value of the Distributing stock surrendered by Shareholder A in the exchange.

(c) The five years of financial information submitted on behalf of Distributing's Business X and Business Y represents the present operations of each business, and regarding each business, there have been no substantial operational changes since the date of the last financial statements submitted.

(d) Except for certain employees that will be paid the fair market value of their services by each corporation as described above, following the Distribution, 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 business purpose: to insulate Business Y from the risks associated with Business X. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(f) 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 entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing 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.

(g) 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.

(h) The Distribution is not part of a plan or series of related transactions (within the meaning of § 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 § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).

(i) The total fair market value of the assets transferred to Controlled by Distributing in the Contribution will equal or exceed the aggregate adjusted basis of the transferred assets.

(j) 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 plus any liabilities to which the transferred assets are subject.

(k) The liabilities to be assumed (as determined under § 357(d)) 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.

(l) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

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

(n) Earnings and profits will be allocated between Distributing and Controlled in accordance with § 312(h) and § 1.312-10(a).

(o) 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.

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 of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately before its transfer (§ 362(b)).

(5) The holding period of 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 Distributing on the Distribution (§ 361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder A on the Distribution (§ 355(a)(1)).

(8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of Shareholder A immediately after the Distribution will equal the shareholder's aggregate basis in the Distributing stock held immediately before the Distribution. Such aggregate basis will be 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)(1), (b)).

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

(10) A proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 312(h) and § 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 Controlled's S Corporation election is a valid election, (ii) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (iii) 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 (iv) whether the Distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under § 355(e).

Procedural Statements

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

A copy of this ruling letter should be attached to the federal income tax return of each taxpayer involved for the taxable year in which the transaction covered by this ruling letter is consummated. 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 ruling letter.

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

Sincerely,

Richard K. Passales

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