

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)), 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 or controlled corporation. (See § 355(e)(2)(A)(ii) and § 1.355-7T).

Summary of Facts

Distributing is a closely held S corporation that has two classes of common stock: Class A and Class B. The Class A and Class B common stock are similar in all respects except that the Class B common stock is non-voting. Distributing conducts Business A and Business B. Financial information submitted by Distributing indicates that Business A and Business B have each 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 have fundamentally different capital and operational needs. To facilitate the allocation of resources to Business A and Business B, Distributing proposes the following transaction (the "Proposed Transaction"):

- i. Distributing will form Controlled with the same capital structure as Distributing (Class A common stock and Class B nonvoting common stock). Distributing will transfer all of the assets of Business B to Controlled in exchange for all of Controlled's stock (the "Contribution"). Controlled will not assume any liabilities in the Contribution. To facilitate the transition of Business B to Controlled, for a period of not more than a months, Employee C will perform services for both Distributing and Controlled.
- ii. Distributing will distribute all of its shares of Controlled's Class A common stock and Class B common stock to its shareholders pro rata with the Distributing shareholders receiving one Class A share of Controlled on each Class A share of Distributing and one Class B share of Controlled on each Class B share of Distributing (the "Distribution").

Representations

The taxpayer has made the following representations in connection with the Proposed Transaction:

- (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 Distributing shareholder.
- (b) The five years of financial information submitted on behalf of Distributing's Business A and Business B 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.
- (c) Except for Employee C who will be paid directly the fair market value of his services by each corporation, following the Proposed Transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
 - (d) The Distribution is being carried out for the following business purpose: fit and focus. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
 - (e) The Proposed Transaction is not being used principally as a device for the distribution of the earnings or profits of Distributing or Controlled or both.
 - (f) Controlled is not assuming any liabilities of Distributing or receiving any assets subject to liabilities from Distributing.
 - (g) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.
 - (h) No two parties to the transactions are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
 - (i) 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.
 - (j) There is no acquisition of stock of Distributing or Controlled (including any predecessor or successor of Distributing or Controlled) 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.
 - (k) 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.
 - (l) 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) Distributing will recognize no gain or loss on the Contribution (§ 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 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 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) the Distributing shareholders upon their receipt of Controlled stock (§ 355(a)(1)).
- (8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of each Distributing shareholder 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(b) and (c)).
- (9) The holding period of the Controlled stock received by the Distributing shareholders, in each instance, 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 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 in the year in which the Proposed Transaction is completed.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer and an additional authorized representative.

Sincerely,

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