

Internal Revenue Service

Number: **200502016**

Release Date: 01/14/2005

Index Number: 355.01-00, 368.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:CORP:B01
PLR-125740-04

Date:
September 29, 2004

In Re:

Legend

Distributing =

Corp X =

d =

Controlled =

Business A =

Business B =

Product M =

Dear _____ :

This letter replies to your ruling request of May 7, 2004 requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated June 22 and September 8, 2004. The information submitted 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, the common parent corporation of a consolidated group, directly conducts Business A and Business B. Distributing has one class of common stock. Corp X holds d percent (a majority) of the stock of Distributing; the other Distributing stock is publicly traded.

Controlled will be newly formed for purposes of the proposed transaction. Controlled will have one class of common stock, all of which will be held by Distributing before the distribution described below.

In order to resolve perceived conflicts arising from operating Business A and Business B in a single corporation, and for other purposes represented as valid business purposes, Distributing has proposed the following transaction (the "Transaction"):

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

(ii) Distributing will distribute all of the stock of Controlled pro rata to its shareholders (the "Distribution"). Distributing shareholders will receive cash in lieu of fractional shares.

(iii) Distributing and Controlled will enter into a Separation and Distribution Agreement, a Tax Sharing Agreement, a Transition Services Agreement, and a Manufacturing Agreement (collectively, the "Agreements") to define their relationships after the Transaction.

Representations

The following representations have been made regarding the Transaction:

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

(b) The 5 years of financial information submitted on behalf of Distributing is representative of the present operations of Business A and Business B, and with regard to such businesses, there have been no substantial operational changes since the date of the last financial statement submitted (except for preparations for the launch of Product M, which is associated with Business B).

(c) Following the Transaction, Distributing and Controlled will each continue the active conduct of its active business, independently and with its separate employees except for the sharing of certain administrative services.

(d) The Distribution is carried out for the following corporate business purposes: (i) increasing aggregate stock value, which may permit Controlled to effect acquisitions in a manner that preserves capital with significantly less dilution; (ii) to ease the pressure to reduce prices on Business B's products arising from the sale of Business A's products by the same corporation, therefore significantly increasing Business B revenues; (iii) enhancing the success of Businesses A and B by facilitating resolution of personnel hiring and compensation issues that arise as a result of Distributing's operation of the two business in a single corporation; and (iv) potentially facilitating a tax-free acquisition of Distributing. The Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.

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

(f) The total adjusted bases 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) of the Internal Revenue Code) by Controlled.

(g) 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) To the extent any of the transfers of property between Distributing and Controlled in connection with the Contribution constitutes an early disposition of property to which any investment credit has been (or will be) claimed under § 46, the income tax liability to which the investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.

(i) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Transaction.

(j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, except for obligations that may arise after the Transaction pursuant to the Agreements.

(k) 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. Distributing's excess loss account with respect to Controlled stock, if any, will be included in income immediately before the Distribution (§ 1.1502-19).

(l) Payments made in connection with all 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.

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

(n) The payment of cash in lieu of fractional shares of Controlled stock is solely for the purpose of avoiding the expense and inconvenience to Controlled of issuing fractional shares and does not represent separately bargained for consideration. The total cash that will be paid in the Distribution to shareholders in lieu of fractional shares of Controlled stock will not exceed one percent of the total consideration that will be distributed in the Distribution. The fractional share interests of each Distributing shareholder will be aggregated, and no Distributing shareholder will receive cash in an amount equal to or greater than the value of one full share of Controlled stock.

(o) 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 and Controlled (including a predecessor or successor of any such corporation).

Rulings

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

(1) The Contribution, together with the Distribution, will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will 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) Controlled's basis in each asset received in the Contribution will equal the basis of such asset in the hands of Distributing (§ 362(b)).

(5) Controlled's holding period in each asset received in the Contribution will include the holding period of that asset in the hands of Distributing (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the shareholders of Distributing on their receipt of Controlled stock in the Distribution (§ 355(a)).

(8) The aggregate basis of the Distributing and Controlled stock in the hands of a shareholder of Distributing after the Distribution (including any fractional share interest in Controlled to which the shareholder may be entitled) will equal the shareholder's basis in the Distributing stock held immediately before the Distribution, allocated between the Distributing stock and Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(a)(1), (b), and (c)).

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

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

(11) Payments made between any of Distributing and Controlled or their subsidiaries and successors under tax sharing agreements between them with respect to tax liabilities that (i) have arisen or will arise for taxable periods ending before the Transaction, and (ii) will not become fixed and ascertainable until after the Transaction will be treated as occurring immediately before the Distribution.

(12) A shareholder who receives cash in lieu of fractional shares of Controlled stock will recognize gain or loss measured by the difference between the basis of the fractional share received, as determined above in ruling (8), and the amount of cash received (§ 1001). If the fractional share interest qualifies as a capital asset in the hands of the shareholder, the gain or loss will be a capital gain or loss subject to the provisions of Subchapter P of Chapter 1 of the Code.

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 the distributing corporation or the controlled corporation 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 who requested it. Section 6110(k)(3) 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.

Under a power of attorney on file in this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

Michael J. Wilder

Michael J. Wilder
Senior Technician Reviewer
Branch 1
Office of Associate Chief Counsel
(Corporate)

cc: