DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Uniform Issue List 409.01-08

JUN 2 a 2005

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Legend:

Company A =

Company B =

Plan X =

Dear

This is in response to your request for a private letter ruling dated June 24, 2004, as supplemented by letters dated August 31, 2004, February 28, 2005, and June 6, 2005, regarding the tax consequences of the spin-off of a subsidiary by its parent corporation. You and your authorized representatives have submitted the following facts and representations in support of your request.

Company A was the parent corporation of its subsidiary Company B. Your authorized representative has represented that Company B is a "subsidiary corporation", as defined in section 424(f) of the Internal Revenue Code ("Code"), of Company A. On_____ Company A completed the spin-off of part of its business to Company B in a corporate reorganization pursuant to Code section 355. Your authorized representative has represented that Company A has received the opinion of its tax advisor that this reorganization satisfies the requirements of Code section 355. Company A contributed and transferred to Company B certain assets, and Company B assumed from Company A certain liabilities, after which there was a public offering of common stock of Company B. Upon the completion of this public offering, Company A distributed its remaining Company B stock to its shareholders by means of a special stock dividend ("Spin-off"). As a result, Company A and Company B are no longer part of the same controlled group of corporations within the meaning of section 414(b), (c), (m) or (o) or section 409(l) of the Code.

Company A maintains Plan X for the benefit of its employees and the employees of its participating subsidiaries. Plan X is a defined contribution plan intended to qualify under Code section 401(a). Plan X includes a cash or deferred arrangement as described in Code section 401(k) and provides for employer matching contributions. Plan X participants are permitted to direct the investment of assets credited to their accounts. Among the investment funds available to Plan X participants is the Company A stock fund, which is a stock bonus plan and an employee stock ownership plan ("ESOP") as described in Code section 4975(e)(7). Plan X is not leveraged.

Company B will establish a defined contribution plan ("Plan Y") intended to qualify under Code section 401(a). Plan Y will include a cash or deferred arrangement as described in Code section 401(k) and will also provide for discretionary employer matching contributions. Plan Y participants will be permitted to direct the investment of assets credited to their accounts. Among the investment funds that will be available to Plan Y participants is the Company B stock fund, which is a stock bonus plan and an ESOP as described in Code section 4975(e)(7). Plan Y will not be leveraged.

In connection with the Spin-off, the Company A shares held in the ESOP portion of Plan X received a stock dividend of Company B shares. The account balances of Company B employees will be transferred from Plan X to Plan Y as soon as administratively feasible after the Spin-off. The transfer is intended to meet the requirements of Code section 414(l). Thus, as a result of the Spin-off, Plan X holds shares of Company B stock and Plan Y holds shares of Company A stock.

Your authorized representative withdrew requested rulings 2, 6 and 7 in a letter dated February 28, 2005, and withdrew requested rulings 8, 9 and 10 in a letter dated June 6, 2005. Please note that requested rulings 1 and 4 apply to Company A and have been addressed in a separate ruling letter to Company A. Please also note that requested ruling 4 is also addressed below because it is related to requested ruling 5. All of the ruling numbers referenced in this paragraph, and the reference to "originally" below, refer to your letter dated June 24, 2004.

Based on the foregoing facts and representations, you have requested the remaining, renumbered rulings:

1 (originally 3). The shares of Company A transferred to Plan Y as a result of the Spin-off will be treated as "securities of the employer corporation" for purposes of Code section 402(e)(4) and Revenue Ruling 73-29, and the net unrealized appreciation in such shares may be excluded from gross income upon distribution by Plan Y to a participant or beneficiary to the extent provided in section 402(e)(4).

2 (originally 4). For purposes of determining net unrealized appreciation under Code section 402(e)(4), to the extent that the Spin-Off is a tax-free spin-off under Code section 355, the basis of the Company A and Company B shares held by Plan X will be determined by allocating the basis in the Company A shares immediately before the Spin-off between the Company A shares and Company B shares held immediately after the Spin-off in accordance with Code section 358.

3 (originally 5). For purposes of determining net unrealized appreciation under Code section 402(e)(4), the basis of the Company A and Company B shares transferred to Plan Y will be determined as described in ruling request 2 and will not be changed by the transfer of those shares from Plan X to Plan Y.

With respect to ruling requests 1 through 3, section 402(e)(4)(B) of the Code provides, that in the case of a lump sum distribution which includes securities of the employer corporation, unless a taxpayer elects otherwise, there shall not be included in gross income the net unrealized appreciation attributable to that part of the distribution which consists of securities of the employer corporation.

Section 402(e)(4)(E) of the Code provides generally that the term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in subsections (e) and (f) of section 424) of the employer corporation.

Section 1.402(a)-1(b)(2)(i) of the Income Tax Regulations provides that the amount of net unrealized appreciation in securities of the employer corporation which are distributed by the trust is the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust. Section 1.402(a)-1(b)(2)(ii) of the regulations sets forth the manner in which the cost or other basis to the trust of a distributed security of the employer corporation is calculated for the purpose of determining the net unrealized appreciation on such security.

In Revenue Ruling 73-29, 1973-1 C.B. 198, securities of an employer corporation held by its qualified plan were transferred to the qualified trust of an unrelated corporation when the first employer sold part of its business and transferred some of its employees to an unrelated corporation. It was held that shares of stock of the seller corporation distributed from the buyer's qualified trust to employees of the buyer corporation who are former employees of the seller corporation are securities of the employer corporation and will always be securities of the employer corporation even after those shares and the employees in whose accounts they were held were transferred to an unrelated corporation.

With respect to ruling request 1, the transfer of Company A shares in the Plan X accounts of Company B employees to Plan Y is analogous to the situation described in Revenue Ruling 73-29. Accordingly, with respect to ruling request 1, we conclude that the shares of Company A transferred to Plan Y as a result of the Spin-off will be treated as "securities of the employer corporation" for purposes of Code section 402(e)(4) and Revenue Ruling 73-29, and the net unrealized appreciation in such shares may be excluded from gross income upon distribution by Plan Y to a participant or beneficiary to the extent provided in section 402(e)(4).

With respect to ruling request 2, Company A has received the opinion of its tax advisor to the effect that the Spin-off will be tax-free under section 355 of the Code. Section 1.358-2(a)(2) of the regulations provides that if, as a result of a transaction under section 355, a shareholder who owned stock of only one class before the transaction owns stock of two or more classes after the transaction, then the basis of all the stock held before the transaction is allocated among the stock

of all classes held immediately after the transaction in proportion to the fair market values of the stock of each class.

Accordingly, with respect to ruling request 2, we conclude that, for purposes of determining net unrealized appreciation under Code section 402(e)(4), to the extent that the Spin-Off is a tax-free spin-off under Code section 355, the basis of the Company A and Company B shares held by Plan X will be determined by allocating the basis in the Company A shares immediately before the Spin-off between the Company A shares and Company B shares held immediately after the Spin-off in accordance with Code section 358.

With respect to ruling request 3, it is represented that the transfer of assets from Plan X to Plan Y meets the requirements of section 414(l) of the Code. In Revenue Ruling 80-138, 1980-1 C.B. 87, the transfer of employer securities from a qualified plan maintained by a parent to a qualified plan maintained by a subsidiary did not change the basis in the securities for purposes of computing net unrealized appreciation, because the transfer, in which no amounts were distributed or made available to the subsidiary's employees, was not a taxable event. In the present case, the transfer of shares of Company A and Company B from Plan X to Plan Y is similar to the transfer of employer securities in Revenue Ruling 80-138 because no amounts are being distributed to participants. Since there is no taxable event the basis in the securities transferred remains unchanged.

Accordingly, with respect to ruling request 3, we conclude that, for purposes of determining net unrealized appreciation under Code section 402(e)(4), the basis of the Company A and Company B shares transferred to Plan Y will be determined as described in ruling request 2 and will not be changed by the transfer of those shares from Plan X to Plan Y.

This ruling letter is based on the assumption that Plan X and Plan Y are qualified under Code section 401(a) at all times relevant to the transactions described herein and that Plan X and Plan Y meet the requirements of 4975(e)(7).

This ruling letter is also based on the assumption that the corporate reorganization described herein meets the requirements of Code section 355.

This ruling is directed solely to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

The original and a copy of this ruling letter are being sent to your authorized representatives in accordance with a power of attorney on file in this office.

If you have any questions about this letter, please contact
Please refer to SE:T:EP:RA:T:3.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures:
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Form 437

cc: