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Refer Reply To:  
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February 01, 2006

LEGEND

Distributing =

Business X =

Activity1 =

Activity2 =

a% =

Shareholder A =

b% =

Shareholder B =

c =

d =

\$e =

Controlled =

\$f =

Dear :

This is in response to a letter dated October 4, 2005, submitted on behalf of Distributing, requesting rulings under section 355 and section 368 of the Internal Revenue Code (the "Code") with respect to a proposed transaction. Additional information was received in letters dated November 9, 2005 and November 22, 2005.

Distributing is an "S" corporation engaged in Business X with Activity1 and Activity2. Distributing files its federal income tax return using the cash method with a tax year ending December 31. Distributing has supplied information indicating that it has had gross receipts and operating expenses representative of the active conduct of a trade or business for each business for each of the past five years. Distributing has one class of stock outstanding, owned approximately a% by Shareholder A and b% by Shareholder B.

Distributing owns approximately c acres of land upon which its business operations are conducted. Distributing has been in operation since d. The fair market value of its assets total an estimated \$e.

Shareholder A focuses on Distributing's Activity1 and Shareholder B focuses on Distributing's Activity2, which is located 25-30 miles from Activity1. Shareholder A and Shareholder B's efforts produce nearly \$f in gross income annually.

For what is represented to be a valid business purpose, the following series of transactions is proposed. The proposed transaction is a "split-off".

- (i) Distributing will create Controlled, a wholly-owned subsidiary.
- (ii) Distributing will contribute half of its assets to Controlled in return for 100% of the stock in Controlled.
- (iii) Distributing will distribute 100% of the Controlled stock in return for 100% of Shareholder A's Distributing stock.
- (iv) Thereafter, Shareholder A will own 100% of Controlled. Similarly, Shareholder B will own 100% of Distributing.

Distributing has made the following representations with respect to the proposed transaction:

- (a) The fair market value of the controlled corporation stock and other consideration to be received by each shareholder of the distributing corporation will be approximately equal to the fair market value of the distributing corporation stock surrendered by the shareholder in the exchange.

- (b) No part of the consideration to be distributed by the distributing corporation will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The five years of financial information submitted on behalf of the distributing corporation is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, the distributing and controlled corporations will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by the distributing corporation prior to consummation of the transaction.
- (e) The total adjusted bases and the fair market value of the assets transferred to the controlled corporation by the distributing corporation each equals or exceeds the sum of the liabilities assumed by the controlled corporation plus any liabilities to which the transferred assets are subject.
- (f) The liabilities assumed 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.
- (g) The distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (h) No intercorporate debt will exist between the distributing corporation and the controlled corporation at the time of, or subsequent to, the distribution of the controlled corporation stock.
- (i) Payments made in connection with all continuing transactions, if any, between the distributing and controlled corporations, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (j) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (k) The distribution of the stock, or stock and securities, of the controlled corporation is carried out for the following corporate business purposes: to match the properties by character, shareholder expertise, and geographic proximity; to remove the present stalemate of strategies and to give each shareholder strategic control over properties complementary to his expertise, thereby allowing each to maximize the potential of the land unfettered by any connection with the other. The distribution of the stock, or stock and securities, of the controlled

corporation is motivated, in whole or substantial part, by one or more of these corporate business purposes.

(l) The transaction is not used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both.

(m) There is no acquisition of stock of the distributing corporation or any controlled corporation (including any predecessor or successor of any such corporation) that is part of a plan or series of related transactions (within the meaning of § 1.355-7) that includes the distribution of the controlled corporation stock.

Based solely on the information submitted and the representations set forth above, we have concluded that:

- (1) The transfer by Distributing of part of its assets in exchange for all of the common stock of Controlled, followed by the distribution of all the Controlled stock to the Distributing shareholder, will constitute a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled will each be "a party to a reorganization" within the meaning of section 368(b) of the Code.
- (2) Distributing will recognize no gain or loss upon the transfer of assets to Controlled in exchange for Controlled stock, as described above (sections 357(a) and 361(a)).
- (3) Controlled will recognize no gain or loss on the receipt of the assets in exchange for all the shares of Controlled (section 1032(a)).
- (4) Controlled's basis in the Distributing assets received by Controlled in the transaction will be the same as the basis of such assets in the hands of Distributing immediately prior to the transaction (section 362(b)).
- (5) Controlled's holding period of the Distributing assets received by Controlled in the transaction will include the period during which such assets were held by Distributing (section 1223(2)).
- (6) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholder on its receipt of Controlled stock in the Distribution (section 355(a)(1)).
- (7) The basis of the Controlled stock in the hands of the Distributing shareholder will be the same as the basis of the Distributing stock held immediately before the exchange by such shareholder (section 358(a)).

- (8) The holding period of the Controlled stock received by the Distributing shareholder will include the holding period of the Distributing stock held by such shareholder, provided that such shareholder held the Distributing stock as a capital asset on the date of the Distribution (section 1223(1)).
- (9) No gain or loss will be recognized to Distributing upon the distribution of its Controlled stock (section 361(c)).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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)), 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)(2)(A)(ii) and § 1.355-7).

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.

A copy of this letter must be attached to any income tax return to which it is relevant. 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 with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

*Douglas C. Bates*

Douglas C. Bates  
Assistant to the Branch Chief, Branch 5  
Office of Associate Chief Counsel  
(Corporate)

cc: