INTERNAL REVENUE SERVICE

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Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:
CC:CORP:4 PLR-146808-03
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December 10, 2003

Legend

Distributing =

Controlled =

LLC 1 =

LLC 2 =

LLC 3 =

LLC 4 =

LLC 5 =

LLC 6 =

LLC 7 =

Corp A	=	
Corp B	=	
Country X	=	
Country Y	=	
Business A	=	
Business B	=	
Business C	=	
Business D	=	
Key Employees	=	
Trust	=	

Date =
a =

b =

c =

d =

e =

Dear

This letter responds to your August 7, 2003 request for rulings regarding certain federal income tax consequences of a series of transactions (collectively, the “Proposed Transaction”). The information submitted in that request 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. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Summary of Facts

Distributing is a domestic corporation and common parent of an affiliated group of corporations that files a consolidated return. Distributing is engaged in Business A and has one class of stock outstanding. Prior to Date, Distributing also conducted Business B and Business D.

Controlled is a limited liability company that is wholly owned by Distributing. As part of the Proposed Transaction (described below), Controlled will be converted into a corporation. In addition to Controlled, Distributing also holds all of the membership interests of LLC 1 and LLC 2, both of which are holding companies.

LLC 1 owns all of the stock of LLC 4. LLC 4 is a corporation engaged in Business C that received Business B on Date. LLC 4 owns all of the stock of Corp A (Country X) and Corp B (Country Y), both of which are engaged in Business C.

LLC 2 owns the stock of LLC 5 and LLC 6, both of which are corporations, as well as the membership interests of LLC 3. LLC 3, LLC 5, and LLC 6 are entities that are engaged in Business D. LLC 3 received Business D on Date.

Financial information has been received which indicates that Business A, Business B, and Business C each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing wishes to provide certain of its key employees and officers (collectively, the "Key Employees") with an equity interest in Distributing that is tied solely to Business A. Distributing believes that a properly motivated team of key employees is crucial to the future success of Business A due to the high degree of competition for key personnel in such business. The Key Employees have also indicated that they do not want the value of the Distributing stock that they receive to be affected by any of Distributing's other businesses or activities, specifically Business B, Business C, and Business D, with which they will not be involved. The taxpayer has documented various alternative transactions that were considered in lieu of the distribution of the stock of Controlled, as described below. However, each of these alternatives was rejected as being either impracticable or unduly expensive. Accordingly, in order to provide the Key Employees with an equity interest in Distributing that will not be affected by any of Distributing's other businesses or activities, the following series of steps have been proposed.

Proposed Transaction

(i) Controlled will convert into a corporation (the "Conversion"). Controlled's capital structure will mirror the capital structure of Distributing.

(ii) Distributing will convert LLC 4, LLC 5, and LLC 6, each of which is currently a corporation, into a limited liability company (collectively, the "LLC Conversions"). Each of LLC 4, LLC 5, and LLC 6 will be treated as a disregarded entity for federal income tax purposes.

(iii) Distributing will transfer $a and its membership interests in LLC 1 and LLC 2 to Controlled. Controlled will assume all of the liabilities associated with Business D, as well as other trade payables associated with Business B and Business C (collectively the "Contribution").

(iv) Distributing will spin off its Controlled stock (the "Distribution"). No fractional shares or cash in lieu of shares of Controlled stock will be issued in connection with the Distribution.

(v) After the Distribution, Distributing will issue b percent of its stock having a fair market value of $c to the Key Employees. Distributing will also distribute an amount of cash to the Key Employees to pay their income taxes on the shares of stock and cash received (hereafter, the “Allocation”). The Key Employees who receive this stock and cash will be asked to sign a § 83(b) election.

(vi) After the Distribution, Trust, a Distributing shareholder, will transfer its Controlled stock to a newly organized limited liability company, LLC 7, in exchange for shares of LLC 7 (hereafter, the “Transfer” and the “LLC 7 Organization”, respectively).

In connection with the Proposed Transaction, Distributing and Controlled have entered into a tax sharing agreement which governs the allocation of tax benefits and liabilities arising on or attributable to periods before the date of the Distribution (hereafter, the “Tax Sharing Agreement”). In addition, Distributing and Controlled have entered into (i) an agreement whereby Distributing and Controlled will share the services of three employees of Distributing for a transitional period following the Distribution, (ii) an agreement whereby Distributing will provide certain routine and minor administrative functions to Controlled for a transitional period following the Distribution, and (iii) an agreement whereby Controlled will lease portions of d and e to Distributing for a limited period of time following the Distribution (collectively the “Ancillary Agreements”). Each of the Ancillary Agreements have been entered into on an arm’s length basis.

Representations

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

(a) The Distribution is not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

(b) No indebtedness owed by Controlled to Distributing after the Distribution, if any, will constitute “stock or securities” within the meaning of § 355.

(c) Each corporation and shareholder will pay their own expenses, if any, incurred in connection with the Proposed Transaction.

(d) Other than indebtedness created in the ordinary course of business through continuing transactions at terms comparable to those which could be obtained in an arm's length transaction, no intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.

(e) 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 Distributing.

(f) Immediately after the Distribution, the gross assets of the active business conducted by Distributing (as defined in § 355(b)(2)) will have a fair market value that is at least five percent of the total fair market value of Distributing's gross assets.

(g) The five years of financial information submitted on behalf of Distributing is representative of its present operations, and there have been no substantial operational changes to Distributing since the date of the last submitted financial statements.

(h) Immediately after the Distribution, the gross assets of Business B and Business C conducted by Controlled (as defined in § 355(b)(2)) will have a fair market value that is at least five percent of the total fair market value of Controlled's gross assets.

(i) The five years of financial information related to Business B and Business C now conducted by Distributing and to be transferred to Controlled is representative of the present operations of these businesses, and with regard to these businesses, there have been no substantial changes since the date of the last submitted financial statements.

(j) Following the Distribution, Distributing will continue, independently and with its own employees, the active conduct of Business A conducted by it before consummation of the Proposed Transaction. To the extent that intercompany relationships continue to exist after the Distribution, such relationships will be the subject of arm's length agreements for which arm's length payments will be made.

(k) Following the Distribution, Controlled will continue, independently and with its own employees, the active conduct of both Business B and Business C conducted by Distributing before consummation of the Proposed Transaction. To the extent that intercompany relationships continue to exist after the

Distribution, such relationships will be the subject of arm's length agreements for which arm's length payments will be made.

(l) The Distribution is being carried out for the corporate business purpose of providing a substantial equity interest in Distributing to the Key Employees. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(m) Following the Distribution, Distributing and Controlled will each either continue as a C corporation or each corporation will elect S corporation status simultaneously at the earliest possible date.

(n) There is no plan or intention by a shareholder or security holder to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or security of, either Distributing or Controlled after the transaction.

(o) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distribution.

(p) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Distribution, except in the ordinary course of business.

(q) 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 stock entitled to vote, or 50 percent or more of the total value of all classes of 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.

(r) 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.

(s) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing will equal or exceed the sum of the liabilities assumed (as defined in § 357(d)) by Controlled plus any liabilities to which the transferred assets are subject.

(t) The liabilities of Distributing assumed (within the meaning of § 357(d)) by Controlled were incurred in the ordinary course of business and are associated with the assets being transferred.

(u) 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 (see §§ 1.1502-13 and 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account, if any, with respect to the stock of Controlled will be included in income before the Distribution (see § 1.1502-19).

(v) Payments made in connection with all continuing transactions after the Distribution 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.

(w) Neither Distributing nor Controlled is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).

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 be a reorganization under § 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 (§§ 361(a), 357(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 Distributing held that asset (§ 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 be included in the income of) a Distributing shareholder upon receipt of Controlled stock in the Distribution (§ 355(a)).

(8) The aggregate basis of the Controlled stock and the Distributing stock in the hands of a Distributing shareholder after the Distribution will equal the shareholder's basis in the Distributing stock immediately before the Distribution, allocated between the Controlled stock and the Distributing stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§§ 358(a), (b), and (c)).

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

(10) As provided in § 312(h), proper allocation of earnings and profits among Distributing and Controlled will be made under § 1.312-10(a).

(11) Payments made by Distributing to Controlled or by Controlled to Distributing under the Tax Sharing Agreement that (a) have arisen or will arise for a taxable period ending on or before the Distribution or for a taxable period beginning before and ending after the Distribution, and (b) will not become fixed and ascertainable until after the Distribution, will be treated as occurring immediately before the Distribution.

Caveats

No opinion was requested and none is expressed about the federal income tax consequences of the Conversion, the Allocation, the LLC Conversions, the Transfer, the LLC 7 Organization, and any payments made pursuant to the Ancillary Agreements. In addition, no opinion is expressed about the tax treatment of the Proposed Transaction under any other provision of the Code or regulations, or the tax treatment of any conditions existing at the time of, or effect resulting from, the Proposed Transaction that are not specifically covered by the above rulings.

Procedural Matters

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

A copy of this letter must be attached to the federal income tax return of each taxpayer involved for the taxable year in which the Proposed Transaction is consummated.

Pursuant to a 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)