Internal Revenue Service

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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:
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PLR-120148-07

Date:
May 31, 2007

Distributing	=
State X	=
Business	=
Date1	=
Shareholder A	=
Shareholder B	=
Shareholder C	=
d	=
e	=
f	=
g	=
h	=

Dear :

We respond to your April 16, 2007, request for rulings regarding certain Federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence dated May 21, 2007, 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)), 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).

Distributing is a State X corporation that directly conducts Business. Distributing was incorporated on Date 1 and elected to be taxed as a subchapter S corporation for Federal income tax purposes as of that date. It is a calendar year taxpayer operating on the cash method of accounting. Financial information has been received indicating that Distributing has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years. Distributing has a single class of voting common stock.

Distributing is owned by three siblings: Shareholder A owns d shares, Shareholder B owns e shares, and Shareholder C owns f shares. To resolve management, systemic, and other problems that have arisen because of irreconcilable differences between and among the three shareholders, the shareholders have proposed to separate the assets of Distributing proportionally in accordance with the three shareholders' relative share interests.

To effectuate the proposed transaction, the shareholders will cause Distributing to form two new corporations, Controlled 1 and Controlled 2. Distributing will transfer approximately g percent of its assets to Controlled 1 in exchange for all of the common stock of Controlled 1 and the assumption by Controlled 1 of approximately g percent of Distributing's liabilities and will contribute h percent of its assets to Controlled 2 in exchange for all of the common stock of Controlled 2 and the assumption by Controlled

2 of approximately h percent of Distributing's liabilities. Each of the controlled corporations will be a cash method taxpayer formed under the laws of State X, and each will elect to be taxed as a subchapter S corporation on the first available date after the distribution. Immediately after the transfer of assets by Distributing to Controlled 1, Distributing will distribute all of the stock of Controlled 1 to Shareholder B in exchange for all of the stock of Distributing owned by Shareholder B and will distribute all of the stock of Controlled 2 to Shareholder C in exchange for all of the stock of Distributing owned by Shareholder C.

Immediately after the distribution, Shareholder A will wholly own all of the outstanding stock of Distributing, Shareholder B will wholly own Controlled 1, and Shareholder C will wholly own Controlled 2. Shareholder A and Shareholder C will not be officers or directors of Controlled 1, and Shareholder A and Shareholder B will not be officers or directors of Controlled 2.

The taxpayers have made the following representations in connection with the proposed transaction described above:

(a) Distributing, Controlled 1, Controlled 2, and each of their respective shareholders will pay their own expenses incurred in connection with the transaction.

(b) The fair market value of the Controlled 1 stock to be received by Shareholder B and the fair market value of the Controlled 2 stock to be received by Shareholder C each will be approximately equal to the fair market value of the Distributing stock surrendered by each shareholder in the exchange.

(c) 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.

(d) The five years of financial information submitted on behalf of Distributing 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.

(e) Following the proposed transaction, Distributing, Controlled 1, and Controlled 2 each will continue, independently and with its separate employees, the active conduct of its share of the Business previously conducted solely by Distributing.

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

(g) The liabilities to be assumed (within the meaning of §357(d)) in the transaction, if any, and the liabilities to which the transferred assets are subject, if any, were incurred in the ordinary course of business and are associated with the assets being transferred.

(h) No investment company property will be transferred by Distributing to Controlled 1 or Controlled 2.

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

(jl) No intercorporate debt will exist between Distributing and either of the controlled corporations at the time of, or subsequent to, the distribution of the stock of Controlled 1 and Controlled 2.

(k) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled 1 or Controlled 2, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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

(m) The distributions of the stock of Controlled 1 and Controlled 2 are carried out for the following corporate business purpose: (a) to resolve shareholder disputes concerning the operation and management of the business; (b) to resolve shareholder disputes concerning the strategic direction of the business; and (c) to resolve shareholder disputes concerning the fundamental business matters. The distributions of the stock of Controlled 1 and Controlled 2 are motivated entirely by that corporate business purpose.

(n) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1, Controlled 2, or collectively.

(o) The distribution is not part of a plan or series of related transactions (within the meaning of §1.355-7) 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, Controlled 1, or Controlled 2 (including any predecessor or successor of any such corporation).

(p) The total fair market value of the assets transferred in the proposed transaction will equal or exceed the aggregate adjusted bases of those assets.

(q) Neither Distributing nor Controlled 1 or Controlled 2 will be a disqualified investment corporation (within the meaning of §355(g)(2)).

Based solely on the information submitted and on the representations set forth above, we rule as follows with respect to the proposed transaction:

(1) The transfer by Distributing to Controlled 1 of part of its assets in exchange for all of the Controlled 1 stock and assumption of liabilities followed by the distribution of all the Controlled 1 stock to Shareholder B in exchange for all of the Distributing stock of Shareholder B will constitute a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled 1 each will be "a party to a reorganization" within the meaning of §368(b). The transfer by Distributing to Controlled 2 of part of its assets in exchange for all of the Controlled 2 stock and assumption of liabilities followed by the distribution of all the Controlled 2 stock to Shareholder C in exchange for all of the Distributing stock of Shareholder C will constitute a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled 2 each will be "a party to a reorganization" within the meaning of §368(b).

(2) Distributing will recognize no gain or loss upon the transfer of assets to Controlled 1 in exchange for Controlled 1 stock and the assumption of liabilities and upon the transfer of assets to Controlled 2 in exchange for Controlled 2 stock and the assumption of liabilities (§§361(a) and 357(a)).

(3) Controlled 1 and Controlled 2 each will recognize no gain or loss on the receipt of assets in exchange for respective Controlled stock and the assumption of liabilities (§1032(a)).

(4) Controlled 1's basis in each asset received from Distributing and Controlled 2's basis in each asset received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (§362(b)).

(5) Controlled 1's holding period of each asset received from Distributing and Controlled 2's holding period of each asset received from Distributing will include the period during which Distributing held such asset (§1223(2)).

(6) Shareholder B and Shareholder C each will recognize no gain or loss (and no amount will otherwise be included in the income of either Shareholder B or Shareholder C) upon receipt of the Controlled 1 and Controlled 2 stock, respectively, in exchange for all of their Distributing stock (§355(a)).

(7) Distributing will recognize no gain or loss on the distribution of the Controlled 1 stock to Shareholder B and the Controlled 2 stock to Shareholder C (§361(c)).

(8) The aggregate basis of the Controlled 1 stock in the hands of Shareholder B and the Controlled 2 stock in the hands of Shareholder C will equal the aggregate basis of the Distributing stock each respectively surrendered in the exchange (§358(a)).

(9) Shareholder B's holding period of the Controlled 1 stock and Shareholder C's holding period of the Controlled 2 stock received in the distribution will include each shareholder's respective holding period of the Distributing stock respectively surrendered in the exchange, provided that the Distributing stock is held as a capital asset on the date of the exchange (§1223(1)).

(10) Distributing's earnings and profits will be allocated between Distributing and Controlled 1 and between Distributing and Controlled 2 in accordance with §312(h) and §1.312-10(a).

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 transaction is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both; 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). Further, no opinion is expressed concerning whether Distributing's S election is valid; whether Controlled 1 and/or Controlled 2 is otherwise eligible to be taxed as a subchapter S corporation; and whether Controlled 1's and/or Controlled 2's elections to be taxed as subchapter S corporations will be valid under §1362(a).

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,

Filiz A. Serbes
Chief, Branch 3
Office of Associate Chief Counsel (Corporate)

cc: