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:
CC:CORP:05
PLR-129888-06

Date:
September 15, 2006

Legend:

Distributing =

Controlled =

Shareholder 1 =

Shareholder 2 =

Business A =

Business B =

Date E =

State F =

Date G =

Date H =

Year 1 =

Sub 1 =

Sub 2	=
Sub 3	=
Sub 4	=
LLC 1	=
LLC 2	=
LLC 3	=
Partner 1	=
Partner 2	=
Partner 3	=
Partner 4	=
Partner 5	=
<u>a</u>	=
<u>b</u>	=
<u>c</u>	=
<u>d</u>	=

e =

f =

g =

h =

i =

j =

k =

m =

n =

Dear :

This is in response to a letter dated June 7, 2006, requesting rulings on certain federal income tax consequences of a proposed transaction. The information provided in that letter 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 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. In particular, this office has not reviewed any information pertaining to, and has made no determination 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 F corporation and is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing, through its foreign and domestic subsidiaries, is engaged primarily in two principal businesses: Business A and Business B. Distributing owns 100% of the stock of Sub 1;

Sub 1 owns 100% of the stock of Sub 2; Sub 2 owns 100% of both the stock of Sub 3 and Controlled; Sub 3 owns 100% of the stock of Sub 4; Sub 4 owns a 100% interest in LLC 1 which is disregarded as an entity for federal income tax purposes. Distributing currently has outstanding common stock, a% of which is owned by Shareholder 1 and b% of which is owned by Shareholder 2. Shareholders 1 and 2 are partnerships for federal income tax purposes. The partners of Shareholder 1 are Partner 1, Partner 2, Partner 3, Partner 4, Partner 5, and Shareholder 2. The partners of Shareholder 2 are Partner 1 and LLC 2. Partner 1 holds only a preferred interest in Shareholder 2.

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

Proposed Transactions

Distributing has proposed separating Business A and Business B for what is represented to be a valid business purpose. The following series of transactions is proposed:

(i) Sub 2 will cause Sub 3 to convert to a limited liability company under state law ("Conversion 1"). As a result, Sub 3 will elect to be disregarded as an entity separate from its owner for federal income tax purposes.
(ii) Sub 1 will cause Sub 2 to convert to a limited liability company under state law ("Conversion 2"). As a result, Sub 2 will elect to be disregarded as an entity separate from its owner for federal income tax purposes.
(iii) Distributing will cause Sub 1 to convert to a limited liability company under state law ("Conversion 3"). As a result, Sub 1 will elect to be disregarded as an entity separate from its owner for federal income tax purposes.
(iv) After the effective date of steps (i) through (iii), Sub 3 will cause Sub 4 to merge into a limited liability company wholly-owned by Sub 3 which will elect to be disregarded as an entity separate from its owner for federal income tax purposes.
(v) Sub 4, following step (iv), will transfer to Controlled all of the membership interests in LLC 1 and Distributing will transfer $c in cash and cash equivalents to Controlled as capital for use in Business B (the "Contribution").
(vi) In redemption of d shares of stock in Distributing held by Shareholder 2, Distributing will distribute all of the stock of Controlled to Shareholder 2 (the "Split-Off").
(vii) Shareholder 2 will distribute all of the stock of Controlled to Partner 1 in redemption of e% of Partner 1's preferred units with an approximate fair market value of $f.
(viii) Prior to Date E, Shareholder 1 will distribute its g shares of common stock of Distributing to its partners, Partner 1, Partner 2, Partner 3, Partner 4, Partner 5, and Shareholder 2, in accordance with each partner's ownership interest in Shareholder 1. Shareholder 2 will distribute its h shares of common stock of Distributing plus the i shares of common stock of Distributing received as a

distribution from Shareholder 1, to its partners, Partner 1 and LLC 2, in accordance with each partner's ownership interest in Shareholder 2. The distribution to Partner 1 will be subject to $j of debt to be assumed by Partner 1. LLC 2 will distribute its interest in the common stock of Distributing to its partners, Partner 2, Partner 4, and LLC 3, in accordance with each partner's ownership interest in LLC 2. LLC 3 will distribute its interest in the common stock of Distributing to its partner, Partner 5, in accordance with Partner 5's ownership interest in LLC 3.

(ix) Partner 1 will exchange k shares of Distributing stock for k shares of non-voting Distributing stock with the same economic terms as the k shares surrendered in the exchange.

(x) Partner 1 will form a wholly-owned LLC ("New LLC") that will elect to be disregarded as an entity separate from its owner for federal income tax purposes. Partner 1 will transfer to New LLC k shares of non-voting Distributing stock, subject to $m of debt, in exchange for preferred and common units of New LLC.

(xi) Partner 1 will establish a trust that will be treated as a grantor trust (the "Grantor Trust") for federal income tax purposes. Partner 1 will gift to the Grantor Trust the common units of New LLC. New LLC will continue to be disregarded as an entity separate from its owner for federal income tax purposes.

(xii) Distributing and Controlled will each elect to be an S corporation pursuant to § 1362(a) effective for the taxable year beginning Date H (the "S Election"), and there is no plan or intent to revoke or otherwise terminate the S Election of either Distributing or Controlled.

(xiii) LLC 1 will incorporate as a State A corporation and will elect to be a qualified subchapter S subsidiary of Controlled.

Representations

The following representations have been made 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 an 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) The five years of financial information submitted on behalf of the controlled corporation is representative of the corporation's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(e) Except for certain transition services described below, following the transactions, the distributing and controlled corporations will each continue the active conduct of its business, independently and with its separate employees. The distributing corporation will provide certain transitional services to the controlled corporation for a period not to extend beyond Date G for a quarterly management fee equal to $n in Year 1. After Date G, it is expected that distributing corporation will provide tax and legal services to controlled corporation for an arms-length fee to be determined.

(f) The distribution of the stock of the controlled corporation is carried out for the following corporate business purposes: to permit management to focus exclusively on achieving the distinctive and complex strategic business plan of either Business A or Business B, but not both; to tailor compensation programs for both businesses; to enhance the valuation of both businesses to potential equity investors; to facilitate potential acquisitions by both businesses; to facilitate the financing of both businesses; to permit cost savings for Business B; and to simplify financial reporting with respect to such businesses. The distribution of stock of the controlled corporation is motivated, in whole or in substantial part, by one or more of these corporate business purposes.

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

(h) There is no plan or intention of the shareholders of the distributing corporation to sell, exchange, transfer by gift, or otherwise dispose of any stock in either the distributing or controlled corporation after the transaction, except for the post-Split-Off distributions and the distribution by Shareholder 2 of the controlled corporation to Partner 1.

(i) There is no plan or intention by either the distributing corporation or the controlled corporation, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction.

(j) There is no plan or intention to liquidate either the distributing or controlled corporation, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.

(k) The total adjusted basis and the fair market value of the assets transferred to the controlled corporation by the distributing corporation equals or exceeds the sum of the liabilities assumed by the controlled corporation plus any liabilities to which the transferred assets are subject (as determined under § 357(d)).

(l) The liabilities assumed by the controlled corporation 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.

(m) The distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(n) 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 other than any indebtedness that may arise after the conclusion of the transaction in connection with any transitional services.
(o) Any indebtedness between the distributing corporation and the controlled corporation after the transaction will not constitute stock or securities.
(p) 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, 1955-32 I.R.B. 6, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, the distributing corporation's excess loss account, if any, with respect to the controlled corporation stock will be included in income immediately before the distribution (See § 1.1502-19).
(q) 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.
(r) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
(s) For purposes of § 355(d), immediately after the transaction, 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 the distributing corporation stock entitled to vote, or 50 percent or more of the total value of shares of all classes of the distributing corporation 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 transaction.
(t) For purposes of § 355(d), immediately after the transaction, 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 the controlled corporation stock entitled to vote, or 50 percent or more of the total value of shares of all classes of the controlled corporation 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 transaction or (ii) attributable to distributions on distributing corporation 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 transaction.
(u) 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 possessing 50 percent or greater interest (within the meaning of § 355(d)(4)) in the distributing or controlled corporation (including any predecessor or successor of any such corporation).
(v) There is no plan or intention to liquidate the partnerships owning an interest in Distributing or Controlled or any interest in the partnerships owned by any of the partners.

(w) The distributing corporation and the controlled corporation intend to each make an S Election effective Date H.

Rulings

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

(1) The Contribution and the Split-Off 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) Distributing will recognize no gain or loss on the Contribution (§ 357(a) and § 361(a)).
(3) Controlled will recognize no gain or loss on the Contribution (§ 1032(a)).
(4) The basis of each asset received by Controlled in the Contribution will be determined in accordance with § 362(b) and § 362(e).
(5) The holding period of each asset received by Controlled in the Contribution will include the period during which Distributing held that asset (§ 1223(2)).
(6) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Shareholder 2 on its receipt of the Controlled common stock (§ 355(a)).
(7) No gain or loss will be recognized by Distributing on the distribution of the Controlled common stock (§ 361(c)).
(8) The aggregate basis of the Controlled common stock in the hands of Shareholder 2 immediately after the Split-Off will equal the aggregate basis of the Distributing common stock held by Shareholder 2 immediately before the Split-Off, and exchanged therefor (§ 358(a)(1)).
(9) The holding period of the Controlled common stock received by Shareholder 2 in the Split-Off will include the holding period of the Distributing common stock on which the distribution of Controlled stock is made, provided the Distributing common stock is held as a capital asset on the date of the Split-Off (§ 1223(1)).
(10) The basis in the Controlled stock distributed by Shareholder 2 to Partner 1 will not be determined under § 732(b); therefore, the Controlled stock will not be treated as acquired by “purchase” by Partner 1 under § 1.355-6(d)(2)(v)(A).
(11) The basis in the Distributing stock distributed by Shareholder 1, Shareholder 2, LLC 2, and LLC 3 will not be determined under § 732(b); therefore, the Distributing stock will not be treated as acquired by “purchase” by the distributees under § 1.355-6(d)(2)(v)(A).

The rulings contained in this letter are based upon information 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.

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. In particular, no opinion is expressed or implied concerning any tax consequences under § 367 or Subchapter N of the Code.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

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.

Sincerely,

_Douglas C. Bates_________

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

cc: