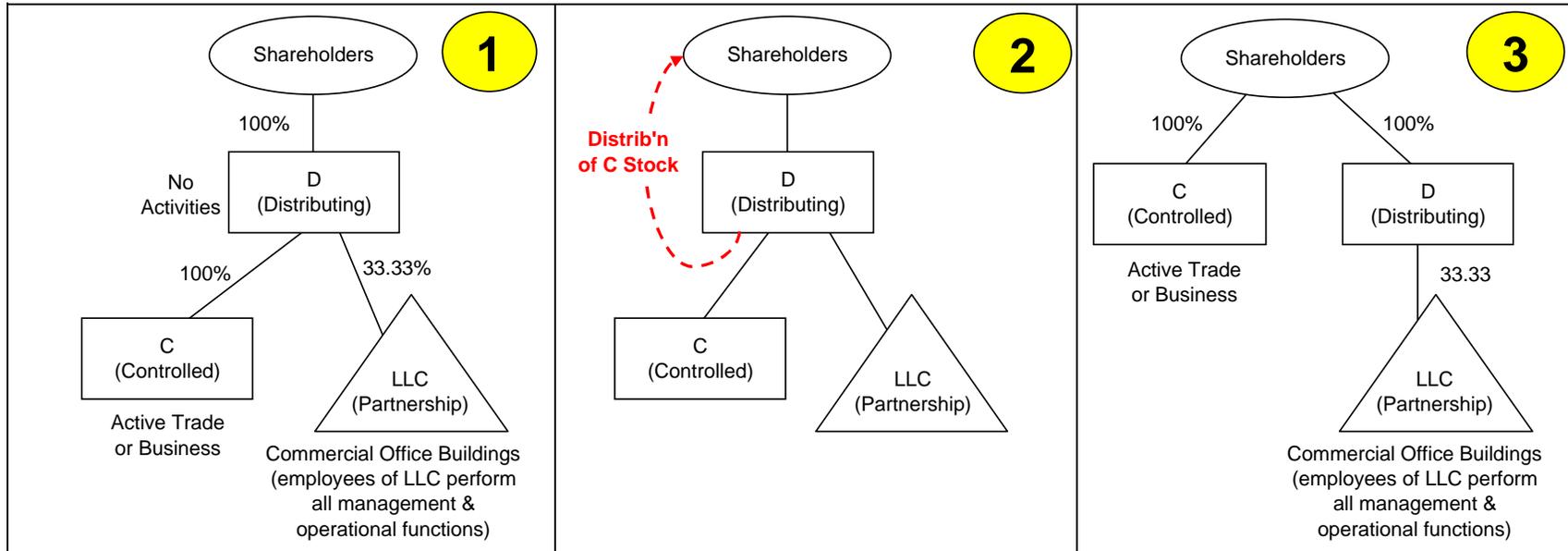


**Spin-Off - 33 1/3 %
Interest in Partnership**

Initial Structure

Spin-Off

Ending Point



LLC is a domestic limited liability company that has been classified as a partnership for Federal tax purposes since its date of organization. For more than five years, LLC has owned several commercial office buildings that are leased to unrelated third parties. LLC has one class of membership interests outstanding. For more than five years, D has owned a 33 1/3 -percent membership interest in LLC, and has owned all the stock of a subsidiary (C), a corporation that has been engaged for more than five years in the active conduct of a trade or business that is unrelated to D's activities. The employees of LLC perform all management and operational functions with respect to LLC 's rental business. Neither D nor any other member of LLC performs services with respect to LLC's business. For a valid business purpose, D proposes to distribute all its C stock pro rata to D's shareholders in a transaction intended to satisfy the requirements of §355. Except for the issue of whether D is engaged in the active conduct of a trade or business under §355(b), the transaction will otherwise meet all the requirements of §355.

Generally, for a trade or business to be actively conducted, the corporation is required itself to perform active and substantial management and operational functions. Generally, activities performed by the corporation itself do not include activities performed by persons outside the corporation, including independent contractors. By comparison, Treas. Reg. §1.368-1(d)(4)(iii)(B), regarding the continuity of business enterprise requirement applicable to corporate reorganizations, provides that the issuing corporation will be treated as conducting a business of a partnership if members of the qualified group, in the aggregate, own an interest in the partnership representing a significant interest in that partnership business. Those regulations indicate that a one-third interest in the partnership represents a significant interest in the partnership business, and a corporation that owns such interest but does not perform active and substantial management functions for the business of the partnership is nevertheless treated as conducting the business of the partnership. In Situation 1, D is engaged in the active conduct of LLC's rental business for purposes of §355(b) because D owns a significant interest in LLC and LLC performs the required activities that constitute an active trade or business under the regulations.