

## Internal Revenue Service

## Department of the Treasury

Number: **200245029**

Release Date: 11/8/2002

Index Number: 0355.00-00

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CC:CORP:3-PLR-119115-02

Date:

August 2, 2002

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

Sub 7 =

Sub 8 =

State A =

business m =

business n =

PLR-119115-02

business o =

Date B =

Date C =

Date D =

Property E =

X =

Y =

Dear :

This letter replies to a request for rulings, dated April 1, 2002, on the federal income tax consequences of a proposed transaction concerning § 355 of the Internal Revenue Code. We have received additional information in letters dated June 21, and August 2, 2002. The information submitted for consideration is summarized below.

Distributing is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year, accrual method basis. Distributing is a State A corporation whose stock is publicly traded. It is engaged in business m, business n, and business o through its subsidiaries. Distributing has submitted, for businesses m, n and o, information representative of the active conduct of a trade or business for each of the past five years. Distributing has two shareholders, X and Y, who own greater than 5 percent of its stock.

Prior to the transaction described below, Sub 1, Sub 5, Sub 6 and Sub 7 were wholly-owned subsidiaries of Distributing. Sub 2, Sub 3 and Sub 4 were wholly-owned subsidiaries of Sub 1. Distributing owned 50 percent of Sub 8 and Sub 7 owned the remaining 50 percent. Sub 2, Sub 3, Sub 4, and Sub 5 were engaged in business n. Sub 6 was engaged in business m and Sub 7 was engaged in business o.

Distributing has provided information that the operation of business m and business n within the same controlled group of corporations has given rise to substantial difficulties. Separation of business m and business n will allow each business to pursue its strategic business plan and operate more efficiently.

PLR-119115-02

Accordingly, the following transaction has been proposed (steps (i) through (iv) have been completed):

- (i) Sub 3 and Sub 4 were merged into Sub 2 on Date B in exchange for additional Sub 2 stock in transactions intended to qualify under § 368(a)(1)(A).
- (ii) Sub 1 transferred all of its assets to Controlled, a State A corporation formed to effectuate the transaction, in exchange for Controlled's assumption of liabilities of Sub 1 and Controlled common stock. Sub 1 then merged into Distributing on Date C.
- (iii) Distributing transferred all of the stock of Sub 5 to Controlled in constructive exchange for additional shares of Controlled stock on Date D. No liabilities were assumed or property transferred subject to liabilities.
- (iv) Distributing contributed all of the stock Sub 7 to Sub 6 on Date D.
- (v) Sub 6 will distribute all of the stock of Sub 7 to Distributing.
- (vi) Distributing will contribute Property E and its stock in Sub 8 to Sub 7.
- (vii) Controlled will transfer the stock of Sub 5 to Sub 2 in constructive exchange for additional shares of Sub 2 stock. No liabilities will be assumed or property transferred subject to liabilities.
- (viii) Distributing will issue 20 percent or less of its common stock to the public.
- (ix) Distributing will distribute all of the Controlled stock pro rata to its shareholders (the "Distribution"). Distributing will not issue fractional share interests of Controlled stock. The fractional share interests will be aggregated and sold on the open market by the distribution agent. The distribution agent will distribute cash to Controlled shareholders in lieu of fractional shares.

The taxpayers have made the following representations in connection with the Distribution:

- (a) Any indebtedness owed by Controlled to Distributing or any other related party after the Distribution will not constitute stock or securities.
- (b) No part of the consideration 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.

PLR-119115-02

- (c) The five years of financial information submitted on behalf of Sub 2, Sub 6 and Sub 7 are representative of each corporation's present operation, and with regard to each corporation, there has not been any substantial operational changes since the date of the last financial statement submitted.
- (d) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock of Sub 6 and Sub 7.
- (e) Immediately after the Distribution, the gross assets of Sub 6's and Sub 7's active trade or business (as defined in § 355(b)(2)) will have a fair market value equal to at least 5 percent of the total fair market value of the gross assets of Sub 6, and Sub 7, respectively.
- (f) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of the stock of Sub 2.
- (g) Immediately after the Distribution, the gross assets of Sub 2's active trade or business (as defined in § 355(b)(2)) will have a fair market value equal to at least 5 percent of the total fair market value of the gross assets of Sub 2.
- (h) Following the Distribution, Sub 2, Sub 6, and Sub 7 will each continue the active conduct of its business, independently and with its separate employees.
- (i) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to alleviate difficulties that exist in operating both business m and business n within the same controlled group of corporations and facilitate the successful growth and development of each. The distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (j) There is no plan or intention by any shareholder who owns 5 percent or more of the stock of Distributing, and the management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular remaining shareholder or security holder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the transaction.
- (k) 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 transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (l) 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

PLR-119115-02

dispose of the assets of either corporation, or any of their subsidiaries, after the transaction, except in the ordinary course of business.

- (m) No intercorporate debt will exist between Distributing or any related party, on the one hand, and Controlled or any related party, on the other hand, at the time of or after the distribution, except that Distributing will provide limited credit support to Controlled in the form of letters of credit.
- (n) 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. Further, there will be no excess loss account with respect to any stock of Distributing, Controlled or any direct or indirect subsidiary thereof, immediately before the distribution.
- (o) Payments made in connection with all continuing transactions between Distributing or any related party, on one hand, and Controlled or any related party, on the other hand, will be for fair market value and based on terms and conditions arrived at by the parties bargaining at arms' length.
- (p) 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 or at least 50 percent of the total value of shares of all classes of stock of either Distributing or Controlled.
- (q) The selling of fractional shares by the distribution agent in lieu of issuing fractional shares of Controlled stock is solely for the purpose of avoiding the expense and inconvenience to Controlled of issuing fractional shares and will not represent separately bargained-for consideration. The total cash consideration to be paid in lieu of fractional shares of Controlled stock will not exceed one percent of the total consideration that will be distributed in the transaction to Distributing's shareholders. The fractional share interests of each Distributing shareholder will be aggregated, and no Distributing shareholder will receive cash in an amount equal or greater than the value of one full share of Controlled stock.
- (r) Neither X nor Y actively participates in the management of Distributing or Controlled.

Based solely on the information submitted and on the representations set forth above, it is held as follows:

PLR-119115-02

- (1) No gain or loss will be recognized by Distributing upon the distribution of its Controlled stock.
- (2) No gain or loss will be recognized by Distributing shareholders (and no amount will be included in their income) upon receipt of Controlled stock (including any fractional share interest to which they may be entitled) (§ 355(a)(1)).
- (3) The aggregate basis of the Distributing stock and the Controlled stock (including any fractional share interest to which they may be entitled) in the hands of each Distributing shareholder after the Distribution will be the same as the shareholder's aggregate basis of the Distributing stock held immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§§ 358(a), (b), and (c)).
- (4) The holding period of the Controlled stock (including any fractional share interest to which they may be entitled) in the hands of the Distributing shareholders will include the period for which such shareholder held the Distributing stock, provided that such stock was held as a capital asset by such shareholder on the date of distribution (§ 1223(1)).
- (5) Where cash is received by a Distributing shareholder in lieu of fractional share interests of Controlled common stock, Distributing will be treated as distributing the fractional share to the shareholder and such fractional share will be treated as having been disposed of by such shareholder for the amount of such cash in a sale or exchange. The gain (or loss), if any, will be treated as a capital gain (or loss), provided such stock was held as a capital asset by the selling Distributing shareholder (§ 1001).
- (6) Proper allocation of earnings and profits between Distributing and Controlled will be made under §§ 1.312-10 and 1.1502-33.

No opinion is requested and no opinion is expressed about the tax treatment of the proposed and partially completed transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Each affected taxpayer must attach a copy of this letter to the taxpayer's Federal income tax return for the tax year in which the transaction covered by this ruling letter is consummated.

PLR-119115-02

We have sent a copy of this letter to your authorized representative pursuant to the power of attorney on file in this office.

Sincerely yours,

*Ken Cohen*

Ken Cohen  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel (Corporate)

cc: