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Department of the Treasury

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Date:

October 29, 1999

A =

B =

Acquiring =

Target =

FC1 =

FC2 =

Temporary =

state W =

province X =

country Y =

country Z =

PLR-108165-99

t =

u =

v =

w =

x =

y =

z =

Other Interests =

the Act =

This responds to a letter dated April 28, 1999, submitted on your behalf by your authorized representative, requesting rulings under section 368(a)(1)(D) of the Internal Revenue Code with respect to a proposed transaction. Additional information was submitted in letters dated August 3, August 11, and October 25, 1999. The information submitted is summarized below.

Target is a corporation incorporated under the federal laws of country Y. Target is a holding company. Its assets consist almost entirely of shares of stock of FC1 and FC2. Target's two shareholders are A and B, individuals who own approximately t (over 90) and u percent (by value), respectively, of the outstanding stock of Target. B has voting control of Target. A is a United States citizen and resident. B, a citizen and resident of country Y, is A's mother.

FC1 is a closely-held corporation organized under the laws of country Z. The other shareholders of FC1 are family members of A, B, and a country Z registered charity ("Trust"). FC2 is a publicly-traded corporation organized under the laws of country Z. Target owns v percent of FC1 and w percent of FC2. FC1 owns x percent of

PLR-108165-99

the common shares of FC2 and 100 percent of a special class of preference shares of FC2. Directly and indirectly, A owns approximately y percent of FC2.

For valid business reasons, it is proposed that A, B and Target enter into the following transaction:

- (i) A will incorporate Acquiring, a state W corporation, and will cause Acquiring to make an S corporation election from inception.
- (ii) A will contribute all of his shares of stock in Target to Acquiring in exchange for all of the shares of stock of Acquiring.
- (iii) Acquiring will organize Temporary, an unlimited liability company (ULC) under the laws of country Y, province X.
- (iv) Acquiring will contribute z dollars to Temporary in exchange for all of the shares of Temporary. Temporary will not be treated as a corporation for U.S. federal income tax purposes.
- (v) Target will reincorporate as a province X corporation.
- (vi) Target and Temporary will amalgamate under province X law. As a result, the two companies will be consolidated and will continue as one corporation. The company resulting from the amalgamation will be a province X ULC which has similar articles to those of Temporary, and which has the same name as Temporary (hereinafter, referred to as "Newco"). In the amalgamation (1) the assets of Target will become the assets of Newco, the amalgamated company, (2) the shares of Target owned by B and Acquiring will be exchanged for shares of Newco, the amalgamated company, and then will be canceled, and (3) Target will cease to exist as a separate company pursuant to the laws of country Y.
- (vii) Upon consummation of the proposed transaction, the stock of Acquiring will be owned 100 percent by A. Acquiring will own all of the voting common stock of Newco. B will own all of the voting preferred and voting special stock of Newco. As was the case with Target, Acquiring's interest will represent t percent in value of Newco.
- (viii) A will contribute his interest in the Other Interests to Acquiring.

The following representations have been made in connection with the proposed transaction:

PLR-108165-99

- (1) The fair market value of the Acquiring stock and other consideration received by each Target shareholder will be approximately equal to the fair market value of the Target stock surrendered in the exchange.
- (2) There is no plan or intention by the shareholders of Target who own 1 percent or more of the Target stock, and to the best of the knowledge of the management of Target, there is no plan or intention on the part of the remaining shareholders of Target to sell, exchange, or otherwise dispose of a number of shares of Acquiring stock received in the transaction that would reduce the Target shareholders' ownership of Acquiring stock to a number of shares having a value, as of the date of the transaction, of less than 50 percent of the value of all of the formerly outstanding stock of Target as of the same date. For purposes of this representation, shares of Target stock exchanged for cash or other property, surrendered by dissenters or exchanged for cash in lieu of fractional shares of Acquiring stock will be treated as outstanding Target stock on the date of the transaction. Moreover, shares of Target stock and shares of Acquiring stock held by Target shareholders and otherwise sold, redeemed, or disposed of prior or subsequent to the transaction will be considered in making this representation.
- (3) Newco will acquire at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Target immediately prior to the transaction. For purposes of this representation, amounts paid by Target to dissenters, amounts paid by Target to shareholders who receive cash or other property, amounts used by Target to pay its reorganization expenses, and all redemptions and distributions (except for regular, normal dividends) made by Target immediately preceding the transfer will be included as assets of Target held immediately prior to the transaction.
- (4) After the transaction, the shareholders of Target will be in control of Acquiring within the meaning of § 368(a)(2)(H).
- (5) Acquiring has no plan or intention to reacquire any of its stock issued in the transaction.
- (6) Newco has no plan or intention to sell or otherwise dispose of any of the assets of Target acquired in the transaction, except for dispositions made in the ordinary course of business.
- (7) The liabilities of Target assumed by Newco plus the liabilities, if any, to which the transferred assets are subject were incurred by Target in the ordinary course of business and are associated with the assets transferred.
- (8) Following the transaction, Newco will continue the historic business of Target or use a significant portion of Target's historic business assets in a business.

PLR-108165-99

- (9) At the time of the transaction, Acquiring will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Acquiring that, if exercised or converted, would affect the Target shareholders' acquisition or retention of control of Acquiring, as defined in § 368(a)(2)(H).
- (10) Acquiring, Target, and the shareholders of Target will pay their respective expenses, if any, incurred in connection with the transaction.
- (11) There is no intercorporate indebtedness existing between Acquiring and Target that was issued, acquired, or will be settled at a discount.
- (12) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (13) The fair market value of the assets of Target transferred to Newco will equal or exceed the sum of the liabilities assumed by Newco, plus the amount of liabilities, if any, to which the transferred assets are subject.
- (14) The total adjusted basis of the assets of Target transferred to Newco will equal or exceed the sum of the liabilities to be assumed by Newco, plus the amount of liabilities, if any, to which the transferred assets are subject.
- (15) Target is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).
- (16) Under the organizational documents of Newco, the members of Newco will have unlimited liability, within the meaning of § 301.7701-3(b)(2)(ii), both before and after the amalgamation. Newco will be formed under the Act.
- (17) In effectuating the formation and amalgamation of Temporary with and into Target with Newco as the survivor, Acquiring does not have a principal purpose to achieve different tax results or consequences under foreign and U.S. law that are inconsistent with the purposes of U.S. tax law.
- (18) Newco, a partnership pursuant to § 301.7701-3(b)(2)(i)(A), will remain a partnership under that provision for the 60-month period beginning with the date of the amalgamation, except to the extent necessitated by a change in U.S. or country Y tax law relating to the classification of Newco as (1) a partnership for U.S. federal tax purposes, or (2) a corporation for country Y tax purposes.
- (19) Target is a "controlled foreign corporation," within the meaning of § 957(a) ("CFC") and has been a CFC at all times during the five-year period immediately preceding the date of the amalgamation.

PLR-108165-99

- (20) With respect to Target, A is a United States shareholder, within the meaning of § 7.367(b)-2(b) of the Temporary Regulations, and will be a United States shareholder on the date immediately preceding the amalgamation.
- (21) With respect to Target, A has been a United States shareholder, within the meaning of § 951(b), at all times since December 31, 1997.
- (22) Beginning with its 1994 taxable year, A elected to treat Target as a “qualified electing fund” within the meaning of § 1295 (“QEF”). Because Target was a CFC at such time, A elected to treat an amount equal to his share of the post-1986 earnings and profits of Target as an excess distribution under § 1291(d)(2)(B). As a result of this purging election, Target was a “pedigreed” QEF, within the meaning of § 1.1291-9(j)(2), at all times from the date of the purging election until December 31, 1997 when § 1297(e) became applicable. A has taken into income each year from 1994 through the end of the 1997 taxable year the amount of income and gain required under § 1293.
- (23) There will not be a transfer of any U.S. assets, directly or indirectly, between Target and Newco in connection with the amalgamation.
- (24) Target will not own, directly or indirectly, any “United States real property interest,” within the meaning of § 897(c)(1)(A) (“USRPI”), immediately before the amalgamation. Newco will not own any USRPIs immediately after the amalgamation. A, Acquiring or B will not transfer, directly or indirectly, any USRPIs to Target or Newco in connection with the amalgamation.
- (25) Target has not been and will not be a “United States real property holding corporation,” within the meaning of § 897(c)(2), at any time during the five-year period ending on the date of the amalgamation.
- (26) FC1 is a foreign corporation, within the meaning of § 7701(a)(3) and (5). FC1 is not a CFC, within the meaning of § 957(a), and has not been a CFC at any time during the five-year period immediately preceding the date of the amalgamation and will not be a CFC immediately after the amalgamation.
- (27) FC2 is a foreign corporation, within the meaning of § 7701(a)(3) and (5). FC2 is not a CFC, within the meaning of § 957(a), and has not been a CFC at any time during the five-year period immediately preceding the date of the amalgamation and will not be a CFC immediately after the amalgamation.

Based upon the information submitted and the representations made, we hold as follows:

PLR-108165-99

- (1) For federal income tax purposes, the transactions described in steps (ii) through (vii), above, will be disregarded and the transaction will be treated as (A) a transfer by Target of t percent of its assets and liabilities to Acquiring in exchange for stock of Acquiring, (B) the distribution by Target of all of the Acquiring stock to A and the remaining Target assets and liabilities to B in exchange for all of A's and B's Target stock, followed by (C) Acquiring and B each contributing the assets and liabilities (plus the z dollars in the case of Acquiring) to Newco in exchange for interests in Newco. Newco will be treated as a partnership for federal income tax purposes under § 301.7701-3(b)(2)(i)(A).
- (2) The transfer by Target of substantially all of its assets to Acquiring in exchange for Acquiring stock and the assumption by Acquiring of the liabilities, if any, of Target, followed by the distribution by Target of the Acquiring stock to A and the remaining Target assets and liabilities to B in exchange for A's and B's Target stock in complete liquidation of Target will constitute a reorganization within the meaning of § 368(a)(1)(D) with respect to which Acquiring and Target will each be "a party to a reorganization" within the meaning of § 368(b). For purposes of this ruling, "substantially all" means at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Target immediately prior to the transactions.
- (3) No gain or loss will be recognized by Target upon the transfer of substantially all of its assets to Acquiring in exchange for Acquiring stock and the assumption by Acquiring of the Target liabilities, if any (§§ 361(a) and 357(a)).
- (4) Target will recognize gain upon the distribution of u percent of its assets to B in exchange for B's Target stock to the extent that the fair market value of such property exceeds its adjusted basis in Target's hands (§ 361(c)(2)). No gain or loss will be recognized to Target upon the distribution of Acquiring stock to A in exchange for A's Target stock (§ 361(c)(1)).
- (5) No gain or loss will be recognized by Acquiring upon the receipt of the assets of Target in exchange for Acquiring stock (§ 1032(a)).
- (6) The basis of the assets of Target in the hands of Acquiring will be the same as the basis of those assets in the hands of Target immediately prior to the transfer (§ 362(b)).
- (7) The holding period of the assets of Target acquired by Acquiring will include the period during which those assets were held by Target (§ 1223(2)).
- (8) No gain or loss will be recognized to A upon the receipt of the Acquiring stock in exchange for his Target stock (§ 354(a)(1)).

PLR-108165-99

- (9) The basis of the shares of Acquiring common stock received by A will be the same as the basis of the Target stock surrendered in exchange therefor (§ 358(a)(1)).
- (10) The holding period of the Acquiring stock to be received by A will include the period during which A held the Target stock surrendered in exchange therefor, provided the Target stock was held as a capital asset on the date of the exchange (§ 1223(1)).

Based solely on the information submitted and on the representations set forth above, and provided that (i) each of Acquiring and Target are corporations within the meaning of § 7701(a)(3), and (ii) A satisfies the requirements of paragraph (c)(1) of § 1.367(b)-1 and paragraphs (c)(2) and (d) of § 7.367(b)-1 of the Temporary Regulations, it is held as follows:

- (11) The § 354 exchange described in ruling (8) above is an exchange to which § 7.367(b)-7(c)(1)(i) applies. Therefore, A must include in gross income the section 1248 amount, as defined in § 1.367(b)-2(d), if any.

No opinion is expressed about the tax treatment of the 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. Specifically, no opinion is expressed regarding (i) Whether the gain recognized by Target upon the distribution of u percent of its assets to B in exchange for B's Target stock would be subpart F income or whether such gain would be included in the "section 1248 amount" to the extent of A's ownership of Target; (ii) The federal income tax consequences with respect to both B's receipt of u percent of Target's assets or the partnership interest in Newco; (iii) The fair market value of the Target stock and the interests in Newco received in exchange therefor by each of Acquiring and B; (iv) The federal income tax consequences of A's transfer of the Other Interests to Acquiring; and (v) Whether the Trust is a grantor trust or a nongrantor trust for federal income tax purposes and whether the Trust's direct and indirect ownership of stock in FC1 and FC2 should be attributable to A and/or B in accordance with § 958 for purposes of determining whether FC1 and FC2 are CFCs, within the meaning of § 957(a).

Moreover, no opinion is expressed regarding whether either of FC1 or FC2 are passive foreign investment companies (within the meaning of § 1297(a) of the Code and the regulations to be promulgated thereunder). If it is determined that any or all of the above-described foreign corporations are passive foreign investment companies, no opinion is expressed with respect to the application of §§ 1291 through 1298 to the proposed transaction. In particular, in a transaction in which gain is not otherwise recognized, regulations under § 1291(f) may require gain recognition notwithstanding any other provision of the Code.

PLR-108165-99

The rulings in this letter are predicated upon the facts and representations submitted by the taxpayers 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 a ruling. Verification of the information, representations, and other data may be required as part of the audit process.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter have not yet been adopted. Therefore, this ruling letter may be revoked or modified upon the issuance of temporary or final regulations (or a notice with respect to their future issuance). See section 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, which discusses in greater detail the revocation or modification of ruling letters. However, when the criteria in section 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

The above rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) of the Code provides that these rulings may not be used or cited as precedent.

Pursuant to a power of attorney on file in this office, we have sent a copy of this letter to your authorized representative.

Sincerely yours,
Assistant Chief Counsel (Corporate)

Ken Cohen
Senior Technical Reviewer, Branch 3