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Person to Contact:

Telephone Number:

Refer Reply To:

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Distributing =

DSub1 =

DSub2 =

DSub2Sub1 =

DSub2Sub2 =

DSub2Sub3 =

DSub3 =

DSub3Sub1 =

DSub3Sub2 =

DSub3Sub3 =

DSub3Sub4 =

DSub4 =

Controlled =

CSub1 =

Business A =

Business B =

State X =

Exchange =

Year 1 =

Date 1 =

Date 2 =

a =

b =

c =

d =

e =

f =

g =

This letter is in reply to a letter dated October 8, 1999, requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was provided in letters dated November 24 and December 23, 1999, and January 5, January 12, and January 31, 2000. The material submitted for consideration is summarized below.

Distributing, a State X corporation, is the common parent of an affiliated group filing a consolidated return. Distributing is a holding company engaged, through direct and indirect subsidiaries, in Business A (and related businesses). Business A is primarily conducted directly by DSub1 and indirectly by DSub2. Both DSub1 and DSub2 are wholly-owned subsidiaries of Distributing. Distributing has a single class of common stock outstanding, which is widely held and publicly traded on the Exchange.

Controlled, a State X corporation, is a holding company engaged, through CSub1, in Business B. Controlled has no directly owned subsidiaries other than CSub1. Controlled was formed in Year 1 to separate Business A and Business B within the Distributing consolidated group.

Controlled has two classes of stock outstanding, which are Class A and Class B voting common stock. The Class B shares have more votes per share than the Class A shares. The Class A and Class B shares otherwise contain identical terms. Distributing owns all of the Class B shares, which represent approximately a percent of the vote and b percent of the value of Controlled's stock. The Class A shares, representing approximately c percent of the vote and d percent of the value of Controlled's stock, are widely held and publicly traded on the Exchange. Controlled's capital structure has been in place since Year 1.

Information has been submitted indicating that Business A and Business B each have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

The management of both Distributing and Controlled have determined that it is in

the best interests of each corporation to focus on its respective core business and, accordingly, to completely separate Business A and Business B by distributing Controlled to its shareholders. While the transaction in Year 1 achieved some separation between Business A and Business B, a complete separation is needed for each corporation to focus on its key business strategies. Documentation has been provided, including the report of an independent consultant, that management, systemic and other problems continue to exist because of Distributing's ownership of Controlled. For example, lost opportunities for Controlled have occurred with respect to Business B because of Distributing's ownership of Controlled.

To accomplish the separation, Distributing and Controlled propose the following transaction (the "Proposed Transaction"):

- (i) Prior to step (ii) below, Controlled will pay a cash dividend in the amount of \$e pro rata to all of its Class A and Class B shareholders (\$f per share). Distributing will use its share of the dividend proceeds to fund its capital expenditure plan and strengthen its balance sheet.
- (ii) Distributing's Class B shares in Controlled will be converted to Class A shares.
- (iii) Distributing will distribute all of its shares of Controlled Class A stock (which represent more than 80 percent of the voting power of Controlled's stock) pro rata to its shareholders. Each shareholder will receive g shares of Controlled stock for each share of Distributing stock owned (the "Distribution"). No fractional shares of Controlled Class A shares will be issued to the holders of Distributing stock pursuant to the Distribution. In lieu thereof, each shareholder of Distributing who would otherwise be entitled to receive a fractional share of Controlled Class A stock will receive cash. As soon as practical after the Distribution, the dividend agent will aggregate and sell all fractional shares of Controlled Class A stock in the open market at then prevailing market prices, and will distribute the aggregate proceeds (net of fees) pro rata to the entitled shareholders.

Prior to the Proposed Transaction, Distributing has or will have taken steps to reorganize certain of its subsidiaries. The following transactions have occurred or may occur prior to the Proposed Transaction (the "Internal Restructuring"):

- (i) On Date1, three wholly-owned subsidiaries of DSub3 (DSub3Sub1, DSub3Sub2, and DSub3Sub3), which is a

wholly owned subsidiary of Distributing, were liquidated into DSub3. DSub3Sub1, DSub3Sub2, and DSub3Sub3 were inactive and did not have any assets. On Date 2, DSub3 was liquidated into Distributing. Also on Date 2, after the liquidation of DSub3, Distributing contributed the stock of DSub3Sub4 (another wholly-owned subsidiary of DSub3) to DSub1. DSub3Sub4, in addition to other business activities, provides training services to the employees in Business A directly conducted by DSub1.

- (ii) DSub2, a wholly-owned subsidiary of Distributing, owns all of the stock of DSub2Sub1. DSub2Sub1 leases equipment to other direct and indirect subsidiaries of DSub2. DSub2Sub1 is indebted to each of DSub2 and Distributing. Distributing and DSub2 will each exchange its current DSub2Sub1 debt for new debt with longer maturity dates. Distributing will transfer its new DSub2Sub1 debt to DSub2 in exchange for debt of DSub2 with identical terms. DSub2 will transfer its new DSub2Sub1 debt and the DSub2Sub1 debt received from Distributing to DSub2Sub2 (another wholly-owned subsidiary of DSub2) in exchange for debt of DSub2Sub2 with identical terms. In addition, DSub2 will transfer all of the stock in DSub2Sub1 to DSub2Sub2 in constructive exchange for stock of DSub2Sub2 of equal value.
- (iii) In addition to the debt exchanges and transfers described in (ii), immediately above, DSub2 will transfer all of the stock and securities in DSub2Sub3 (another wholly-owned subsidiary of DSub2) to DSub2Sub2 in constructive exchange for stock of DSub2Sub2 of equal value.
- (iv) Various intercompany accounts receivable existing among Distributing and its subsidiaries (other than Controlled and its subsidiaries) will either be settled, contributed to capital or exchanged for other indebtedness.

The following representations have been made concerning the Proposed Transaction:

- (a) The indebtedness, if any, owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Distributing will be received by a Distributing shareholder as a creditor, employee, or in any

capacity other than that of a shareholder of Distributing.

- (c) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock and securities of controlled corporations that are directly or indirectly engaged in the active conduct of a trade or business as defined in § 355(b)(2). Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of the stock and securities of controlled corporations that are directly or indirectly engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (d) Immediately after the Distribution, the gross assets of each Distributing subsidiary conducting Business A (and related businesses) and CSub1, used in the conduct of each corporation's business will have a fair market value equal to or greater than five percent of the total fair market value of the gross assets of such corporation.
- (e) The five years of financial information submitted on behalf of Distributing's subsidiaries conducting Business A (and related businesses) and CSub1 conducting Business B are representative of each corporation's present operations, and with regard to each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) Following the Distribution, the Distributing subsidiaries directly engaged in Business A (and related businesses) and CSub1 will each continue the active conduct of its business, independently and with its separate employees.
- (g) The Distribution is carried out for the following corporate business purpose: to enhance the success of Business A and Business B by enabling Distributing to resolve management, systemic, or other problems that arise because of (or are exacerbated by) Distributing's operation of these different businesses within Distributing's affiliated group. The Distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (h) There is no plan or intention by any shareholder who owns five 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 Distribution.

- (i) 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 Distribution, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (j) There is no plan or intention to liquidate either Distributing or Controlled, to merge either Distributing or Controlled with any other corporation, or to sell or otherwise dispose of the assets of Distributing or Controlled after the Distribution, except in the ordinary course of business.
- (k) Except for accounts payable that arise in connection with continuing services between Distributing or its post-Distribution subsidiaries and Controlled or its post-Distribution subsidiaries, no intercorporate debt will exist between Distributing or its post-Distribution subsidiaries and Controlled or its post-Distribution subsidiaries at the time of, or subsequent to, the Distribution of the Controlled stock.
- (l) 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. Furthermore, Distributing's excess loss account with respect to Controlled stock (if any) will be included in income immediately before the Distribution (see § 1.1502-19).
- (m) Payments made in connection with all continuing transactions between Distributing or its post-Distribution subsidiaries and Controlled or its post-Distribution subsidiaries will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (n) 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 of Distributing or Controlled or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.
- (o) The payment of cash in lieu of fractional shares of Controlled's Class A shares is solely for the purpose of avoiding the expense and inconvenience to Distributing of issuing fractional shares and does not represent separately bargained for consideration. The total cash consideration that will be paid in the transaction to the Controlled shareholders instead of issuing fractional shares of Controlled stock will not exceed one percent of the total consideration that will be distributed in the transaction to the Distributing shareholders. The fractional share

interests of each Distributing shareholder will be aggregated, and no Distributing shareholder will receive cash in an amount equal to or greater than the value of one full share of Controlled Class A stock.

Based on the information submitted and representations made, we rule as follows on the Proposed Transaction:

- (1) The distribution by Controlled to Distributing described in step (i) above will not be included in the gross income of Distributing (§ 1.1502-13(f)(2)).
- (2) No gain or loss will be recognized by Distributing upon the distribution of Controlled Class A shares to Distributing's shareholders (§ 355(c)).
- (3) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders upon the receipt of Controlled Class A shares (§ 355(a)(1)).
- (4) The aggregate basis of the Distributing and Controlled Class A shares in the hands of the Distributing shareholders immediately after the Distribution will be the same as the aggregate basis of the Distributing stock held by the Distributing shareholders immediately before the Distribution, allocated between the Distributing and Controlled Class A shares in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§§ 358(a)(1) and (b)).
- (5) The holding period of the Controlled Class A shares received by a Distributing shareholder will include the holding period of the Distributing shares with respect to which the distribution is received, provided the Distributing shares are held as a capital asset on the date of the distribution (§ 1223(1)).
- (6) Any payment of cash in lieu of fractional shares of Controlled Class A shares will be treated for federal income tax purposes as if the fractional shares were issued in the Distribution and then were redeemed by Controlled. The cash payments will be treated as having been received as a distribution in full payment in exchange for the shares redeemed as provided in § 302(a). Provided the fractional share interest is a capital asset in the hands of the recipient shareholder, the gain or loss will constitute capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1. Rev. Rul. 66-365, 1966-2 C.B. 116; Rev. Proc. 77-41, 1977-2 C.B. 574.
- (7) Earnings and profits will be allocated between Distributing and Controlled in accordance with § 312(h) and §§ 1.312-10(b) and 1.1502-33(e).

We express no opinion about the federal income tax treatment of this 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. In particular, no rulings were requested, and no opinion is expressed, concerning the tax treatment of the exchange in step (ii) of the Proposed Transaction or the tax treatment of any of the transactions in the Internal Restructuring described above.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) 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.

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,

Assistant Chief Counsel (Corporate)

By: Michael J. Wilder

Michael J. Wilder
Assistant to the Chief, Branch 3