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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
February 16, 2000

In Re:

Parent =

Sub A =

Distributing =

Sub 1 =

Sub 2 =

Sub 3 =

Individual =

a% =

b% =

c% =

d% =

e% =

f% =

Business A =

Business B =

Dear :

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This is in response to a letter dated August 9, 1999, in which rulings are requested as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated November 8, and November 29, 1999. The facts submitted for consideration are substantially as set forth below.

Distributing is a foreign corporation that is primarily a holding company for Sub 1, Sub 2, and Sub 3 stock. The outstanding stock of Distributing is owned by Parent and Individual. Distributing owns all of the outstanding stock of Sub 1, a% of Sub 2, and b% of Sub 3.

Sub 1 is a foreign corporation that is engaged in Business A. Sub 2 is a foreign corporation that is primarily a holding company. Sub 3 is a foreign corporation that is engaged in Business B.

Of Sub 2's remaining outstanding stock, c% is owned by Sub A, a wholly owned foreign subsidiary of Parent, and d% is owned by Individual, a non-U.S. citizen. Sub 2 holds e% of Sub 3's outstanding stock.

Financial information has been submitted indicating that Sub 1 and Sub 3 each has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the last 5 years.

Distributing's Management and Individual have maintained a long term working relationship based on similar philosophies and business goals. Recent differences in philosophies and goals has caused friction in the working relationship of the two factions, the resolution of which would be attained by separating Sub1 from Sub 2 and Sub 3. Accordingly, the following transaction is proposed:

(i) Distributing will contribute all of its stock interest in Sub 3 and inventory to Sub 2 solely in exchange for Sub 2 stock. As a result of this transfer Distributing will own in excess of 80 percent of Sub 2's outstanding stock.

(ii) Sub 2 will transfer the inventory received from Distributing to Sub 3 solely in exchange for Sub 3 stock.

(iii) Sub 3 will make a dividend distribution to Sub 2. Sub 2 will use the proceeds to redeem its stock owned by Sub A. After the redemption, Distributing will own approximately f% of the outstanding shares of Sub 2.

(iv) Distributing will incorporate a new foreign corporation (Controlled)

(v) Distributing will transfer its shares of Sub 1 to Controlled solely in exchange for all of the outstanding stock of Controlled.

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(vi) The shares of Controlled will be distributed to Parent in exchange for all of the outstanding stock of Distributing.

(vii) Cash and receivables will be distributed by Distributing to Individual.

In connection with the transaction, it has been represented that:

- (a) There will be no continuing relationship between Distributing and Controlled including their having common directors, officers, or key employees, the provision of goods and services by one to the other company, except for the possible provision of goods and services by one of the other company at arm's length, or their commonly owning property.
- (b) Distributing and Controlled and their respective shareholders will each pay their own expenses, if any, incurred in connection with the transaction.
- (c) The value of the Sub 2 shares received by Distributing is equal to the value of the Sub 3 shares and inventory transferred in exchange therefor.
- (d) The fair market value of the Controlled stock and other consideration to be received by Parent from Distributing will be equal to the fair market value of the Distributing stock surrendered by Parent in the exchange.
- (e) No part of the consideration to be distributed by Distributing will be received by Parent as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (f) The 5 years of financial information submitted on behalf of each of Distributing, Sub 1, Sub 2, and Sub 3 is representative of the 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.
- (g) Immediately after the transaction, at least 90 percent of the fair market value of the gross assets of each of Distributing and Controlled will consist of the stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (h) No liabilities will be assumed by Controlled in the transaction.
- (i) There is no plan or intention for either Parent or Individual to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in Controlled or Distributing, respectively, after the transaction.

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- (j) 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.
- (k) Following the transaction, Distributing (indirectly through Sub 2 and Sub 3) and Controlled (indirectly through Sub 1) will each continue the active conduct of their business, independently and with separate employees.
- (l) There is no plan or intention to liquidate either Distributing or Controlled, or 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.
- (m) No intercorporate debt will exist between the Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (n) No two parties to the transaction are investment companies as defined in § 368(a)(2)(f)(iii) and (iv)
- (o) After the transaction, the shareholders have no plan or intention to dispose of the shares of Distributing, Controlled, Sub 1, Sub 2, or Sub 3.
- (p) There will be no continuing transactions between Distributing and Controlled following the distribution, either directly or indirectly. However, on occasion, other members of the Parent affiliated group may purchase some of Sub 3's product.
- (q) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled and Sub 1, will be for fair market value based on terms and conditions arrived at by parties bargaining at arm's length.
- (r) Distributing and Controlled are corporations as defined in § 7701(a)(3) and are foreign corporations within the meaning of § 7701(a)(5).
- (s) Distributing, Controlled, Sub A, Sub 1, Sub 2 and Sub 3 are controlled foreign corporations ("CFCs") as defined in § 957 before the proposed split-off.
- (t) Following the proposed split-off, Controlled, Sub A and Sub 1 will remain CFCs, whereas, Distributing, Sub 2 and Sub 3 will no longer qualify as such.

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- (u) Neither Distributing, Controlled, Sub A, Sub 1, Sub 2 nor Sub 3 is a passive foreign investment company as defined in § 1297.
- (v) The requirements of § 1.367(b)-1(c)(1) of the Income Tax Regulations will be met with respect to the proposed split-off.
- (w) Necessary adjustments to earnings and profits, basis of stock or securities, and basis of assets required by § 367(b) and the § 367(b) regulations will be made in connection with the proposed split-off.

Based solely on the information submitted and the representations set forth above, and provided that: (1) Distributing and Controlled are each a corporation within the meaning of § 7701(a)(3), and (2) the requirements of § 1.367(b)-1(c), it is held as follows:

- (1) The transfer by Distributing to Controlled of the Sub 1 stock exchange for all the stock of Controlled, as described above, followed by the distribution of the Controlled stock to Parent will be a reorganization within the meaning of § 368(a)(1)(D) of the Code. Distributing and Controlled will each be a “party to a reorganization” within the meaning of § 368(b).
- (2) No gain or loss will be recognized to Distributing upon the transfer of Sub 1 stock to Controlled in exchange for Controlled stock as described above (§ 361(a)).
- (3) The basis of the Sub 1 stock received by Controlled will be the same as the basis of such asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (4) No gain or loss will be recognized to Distributing upon the distribution of all of the stock in Controlled (§ 361(c)(1)).
- (5) No gain or loss will be recognized by Controlled upon receipt of property in exchange for its stock (§ 1032(a)).
- (6) No gain or loss will be recognized to (and no amount will be included in the income of) Parent upon the receipt of the Controlled stock in exchange for its stock in Distributing (§ 355(a)(1)).
- (7) The basis of the stock of Controlled in the hands of Parent will be the same as the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

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- (8) There holding period of the Controlled stock will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset on the date of the exchange (§ 1223(1)).

Notwithstanding the above rulings, Distributing's transfer of Sub 1 stock to Controlled in exchange for Controlled stock is a reorganization to which § 1.367(b)-4(a) applies, and Distributing's distribution of the Controlled stock to Parent in exchange for Distributing stock is an exchange to which § 1.367(b)-5(a), § 1.367(b)-5(d), and § 1.367(b)-5(f) apply.

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

No opinion is expressed on: (1) whether the transfer of the inventory by Distributing to Sub 2 and by Sub 2 to Sub 3 should be stepped with the dividend distribution by Sub 3 to Sub 2 that the inventory is viewed not as exchanged under § 351 but as sold by Sub 2 to Sub 3; or (2) whether any income on any such sale of inventory constitutes foreign base company sales income under § 954(d), subject to inclusion in Parent's income under § 951. See also § 1.367(b)-4.

No opinion is expressed on the application of § 1.367(b)-4 to Distributing's transfer of the Sub 3 stock to Sub 2.

No opinion is expressed regarding the redemption of the Sub 2 stock owned by Sub A under § 302 and whether any gain under § 302 constitutes foreign personal holding company income under § 954(c), subject to inclusion in Parent's income under § 951. See also § 964(e).

In addition, no opinion is expressed about the tax treatment of the proposed split-off 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 proposed split-off that are not specifically covered by the above rulings.

Temporary or final regulations pertaining to one or more issues addressed in this ruling letter have not yet been adopted. Therefore, this ruling letter may be revoked or modified, in whole or in part, on the issuance of the temporary or final regulations (or a notice with respect to their future issuance). See section 12.04 of Rev. Proc. 99-1,

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1999-1 I.R.B. 6, which discusses the revocation or modification of ruling letters. However, when the criteria in section 12.05 of Rev. Proc. 99-1 are satisfied, a ruling will not be revoked or modified retroactively except in rare or unusual circumstances.

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

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Pursuant to a power of attorney on file in this office, a copy of this letter is being sent to the taxpayer's authorized representative.

Sincerely yours,
Assistant Chief Counsel (Corporate)

By Debra Carlisle
Chief, Branch 5