

## Internal Revenue Service

## Department of the Treasury

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Refer Reply To:

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Date: April 20, 2001

Parent =

Distributing =

Controlled 1 =

Controlled 2 =

State W =

Business A =

Business B =

Agency =

Agency Rules =

Dear \_\_\_\_\_ :

We respond to your authorized representative's letter of November 7, 2000, requesting rulings regarding the tax treatment of a proposed transaction. Additional information was provided under her letter of April 5, 2001. The pertinent facts as described in the request are set forth below.

Parent, a State W corporation, is the common parent of an affiliated group of corporations whose includible members file a consolidated return for federal income tax purposes. Parent owns all of the stock of Distributing, a State W corporation engaged in Business A. Distributing owns all of the stock of Controlled 1 and Controlled 2. Both Controlled 1 and Controlled 2 are State W corporations that are actively engaged in Business B.

Financial information has been submitted indicating that Distributing, Controlled 1, and Controlled 2 each have had gross income and operating expenses representing the conduct of an active business during each of the past five years.

Distributing, Controlled 1, and Controlled 2 are each subject to substantial regulatory oversight by several governmental authorities, including Agency. Of particular concern are Agency Rules governing Distributing's Business A operations. The Agency Rules impose significant limitations on cash distributions that may be made from Controlled 1 and Controlled 2 to Parent through Distributing. These Agency Rules adversely affect the operations of Parent and the ability of Controlled 1 and Controlled 2 to provide needed capital to Parent in the form of cash distributions. To eliminate the dividend paying restrictions of the Agency Rules, Distributing proposes to distribute all of the stock of Controlled 1 and all of the stock of Controlled 2 to Parent.

The taxpayer has made the following representations with respect to the proposed transaction:

- (a) 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 the corporation.
- (b) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) The five years of financial information submitted on behalf of Controlled 1 is representative of the corporation's present operation, and with regard to such corporation,

there have been no substantial operational changes since the date of the last financial statements submitted.

- (d) The five years of financial information submitted on behalf of Controlled 2 is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) The fair market value of the gross assets of Business A constitutes at least five percent of the total fair market value of all the gross assets of Distributing. In addition, the fair market value of the gross assets of Business B constitutes at least five percent of the total fair market value of all the gross assets of Controlled 1 and Controlled 2, respectively.
- (f) Following the transaction, Distributing, Controlled 1, and Controlled 2 will each continue, independently and with its separate employees, the active conduct of its business.
- (g) The distributions of the stock of Controlled 1 and Controlled 2 are being carried out for the following corporate business purpose: To eliminate the dividend paying restrictions applicable to Distributing under the Agency Rules. The distributions of the stock of Controlled 1 and Controlled 2 are motivated, in whole or substantial part, by this corporate business purpose.
- (h) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, Distributing, Controlled 1, or Controlled 2 after the transaction.
- (i) There is no plan or intention by Distributing, Controlled 1, or Controlled 2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction.
- (j) There is no plan or intention to liquidate Distributing, Controlled 1, or Controlled 2, to merge any of these corporations with any other corporation, or to sell or otherwise dispose of the assets of any of these corporations after the transaction, except in the ordinary course of business.
- (k) No intercorporate debt will exist between Distributing and Controlled 1, or Distributing and Controlled 2, at the time of, or subsequent to, the distributions of the stock of Controlled 1 and Controlled 2.

- (l) Immediately before the distributions, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (See §1.1502-13 and §1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; §1.1502-13 as published by T.D. 8597). Further, Distributing does not have an excess loss account with respect to the Controlled 1 or Controlled 2 stock.
- (m) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled 1, and Distributing and Controlled 2, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (n) The distributions are not part of a plan or series of related transactions 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, Controlled 1, or Controlled 2, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing, Controlled 1, or Controlled 2, within the meaning of section 355(e).

Based solely on the information submitted and on the representations set forth above, we hold as follows with respect to the proposed transaction:

- 1. No gain or loss will be recognized to (and no amount will be included in the gross income of) Parent upon the receipt of all of the stock of Controlled 1 and Controlled 2 from Distributing. Section 355(a)(1).
- 2. No gain or loss will be recognized by Distributing upon the distribution of all the stock of Controlled 1 and Controlled 2 to Parent. Section 355(c)(1).
- 3. The aggregate basis of the Controlled 1, Controlled 2, and Distributing common stock in the hands of Parent after the distributions will be the same as the basis of the Distributing common stock held immediately before the distributions, allocated in proportion to the fair market value of each in accordance with sections 1.358-2(a)(2) and (a)(4) of the Income Tax Regulations.
- 4. The holding period of the Controlled 1 and Controlled 2 stock received by Parent will include the holding period of the Distributing stock with respect to which the distributions will be made, provided that the Distributing stock is held as a capital asset on the date of the distributions. Section 1223(1).

5. As provided in section 312(h), proper allocation of earnings and profits between Distributing, Controlled 1, and Controlled 2 will be made under section 1.312-10(b) of the Income Tax Regulations.

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

A copy of this letter should be attached to the Federal Income Tax Return of Parent for the taxable year in which the transaction covered by this letter ruling is consummated.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer and an authorized representative.

Sincerely yours,

Associate Chief Counsel (Corporate)

By: \_\_\_\_\_  
Gerald B. Fleming  
Senior Technician Reviewer, Branch 2

cc: Internal Revenue Service  
Attn: Industry Director,