

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP-PLR-118652-99

Date:

July 19, 2000

Foundation =

FP =

DP =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

Sub 7 =

X Business =

Y Business =

Services =

Country =

Outside Consultants =

Officer =

Pension Fund =

Date 1 =

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Date 2 =

Date 3 =

Year 1 =

\$a =

b =

c =

d =

e =

Dear :

This is in reply to a letter dated November 22, 1999 requesting rulings regarding a proposed transaction. Additional information was provided in subsequent submissions.

The facts provided indicate that FP is a Country corporation. FP has two classes of common stock, Class A and Class B. Class A has 10 votes per share and Class B has one vote per share. Class B shares are entitled to dividends of up to d percent of profits while the class A shares are entitled to dividends of up to c percent of profits. Until Date 3, all of FP's Class A shares of common stock were owned by Foundation. Foundation transferred its FP stock to a newly formed subsidiary on Date 3. The Class B stock is publicly traded on various stock exchanges. Pursuant to a repurchase plan, FP has reacquired approximately b percent of the total FP stock outstanding.

FP and its subsidiaries engage in the X Business and the Y Business. Prior to Year 1, FP's Y Business needed additional capital. However, Outside Consultants indicate it was inappropriate for the X Business to have significant debt on its balance sheet because of the greater risk and return expected in the X Business. Therefore, FP's X Business provided the Y Business with capital. In anticipation of the transaction described below, on Date 1, FP obtained a loan in the amount of approximately \$a from an unrelated party to reimburse FP's X Business for the capital provided to the Y Business over the years.

FP owns all of the stock of DP. DP owns all of the stock of Sub 1, Sub 2, and Sub 3 (together, the "Y Business Subsidiaries"). Sub 3 is a foreign corporation. DP also owns all of the stock of Sub 7 and Sub 4, which owns Sub 5 and Sub 6, (together, the "X Business Subsidiaries"). DP performs Services for both the X Business Subsidiaries and the Y Business Subsidiaries. On Date 2, DP contributed the intangible property it owned to Sub 6.

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After consultation with Outside Consultants, the management of FP proposes to separate the X Business from the Y Business. Based upon discussions with the top executives of the Y Business, and with the advice of Outside Consultants, management has concluded that, to attract and retain high quality executives and provide the financial incentives for the highest levels of performance from such individuals, it is necessary to offer key members of the Y Business management (identified in the submission and the amount of stock they intend to purchase) the opportunity to purchase stock in a publicly traded corporation that solely conducts the Y Business.

Therefore, to accomplish the above stated business purpose, the following steps are proposed:

- I. DP will create Domestic Controlled and contribute all of its stock in the “Y Business Subsidiaries” to Domestic Controlled in exchange for all of Domestic Controlled’s common stock (the “DP Contribution”).
- II. DP will then distribute all of the Domestic Controlled common stock to FP (the “DP Distribution”).
- III. Under Country law, FP will undergo a tax-free demerger transaction, effectively splitting FP into two separate operating corporations; FP which will conduct the X Business, and a newly formed corporation, Foreign Controlled, which will conduct the Y Business. For Country corporate purposes, the demerger will occur in a single step. By operation of Country law, Foreign Controlled will come into existence owning the assets and liabilities associated with the Y Business and the shareholders of FP will be issued stock in Foreign Controlled in the same number and the same class as their interests in FP.

The Service will treat for federal income tax purposes the demerger under Country law as (1) the creation of a newly formed Country corporation, Foreign Controlled, by FP, (2) the transfer of certain subsidiaries, including Domestic Controlled, and certain business assets and liabilities, including the liability associated with the Date 1 loan, by FP to Foreign Controlled in exchange for Foreign Controlled stock (FP Contribution), and (3) the pro rata distribution by FP of the Foreign Controlled stock to its shareholders (FP Distribution).

Outside Consultants advised FP to accompany the demerger with a public offering of Foreign Controlled stock. Rather than have Foreign Controlled issue stock directly in the public offering, Outside Consultants advised that Foreign Controlled issue stock to FP in the demerger which FP will then offer in the public offering (the “recirculation facility”). Except for c% which will be used to pay existing stock options, all of the Foreign Controlled stock to be received by FP in the demerger will be sold in the public offering conducted contemporaneously with the demerger. The existing

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stock options expire in e years.

After the transaction, DP will continue to perform Services for the Y Business Subsidiaries under a Services agreement. Under the Services agreement, the subsidiaries will pay DP an arm's length service fee on an hourly basis for these services until Domestic Controlled assumes these functions. In addition, FP and Foreign Controlled will enter into leases for real property (land and buildings) jointly occupied by the X Business and Y Business.

The following representations have been given:

- a. No part of the consideration to be distributed by DP will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- b. Immediately after the DP Distribution, at least 90 percent of the fair market value of the gross assets of DP will consist of the stock and securities of controlled corporations that are engaged in the active conduct of a trade or business.
- c. The five years of financial information submitted on behalf of Sub 4 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. Immediately after the DP Distribution, at least 90 percent of the fair market value of the gross assets of Domestic 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 section 355(b)(2).
- e. The five years of financial information submitted on behalf of Sub 1 and Sub 2 is representative of the corporations' present operation, and with regard to such corporations, there have been no substantial operational changes since the date of the last financial statements submitted.
- f. Following the transaction, DP, Sub 4, Sub 1, and Sub 2 will each continue the active conduct of their business, independently and with its separate employees.
- g. The distribution of the stock of Domestic Controlled by DP is carried out for the following corporate business purpose: offering of shares in a publicly traded Y Business to senior management of the Y Business and attracting industry expert corporate directors. The DP Distribution is motivated, in whole or substantial part, by one or more of these corporate

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business purposes.

- h. Other than FP Contribution and the FP Distribution, there is no plan or intention by any shareholders or security holders of DP to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either DP or Domestic Controlled after the transaction.
- i. There is no plan or intention by either DP or Domestic 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.
- j. With the exception of the FP Contribution and the FP Distribution, there is no plan or intention to liquidate either DP or Domestic Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the DP Distribution, except in the ordinary course of business.
- k. For purposes of section 355(d), immediately after the DP Distribution, no person will hold disqualified stock (under section 355(d)(3)) in DP or Domestic Controlled possessing 50 percent or more of the total combined voting power of all classes of DP or Domestic Controlled stock entitled to vote or 50 percent or more the of the total value of shares of all classes of DP or Domestic Controlled stock.
- l. DP neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the DP Distribution.
- m. With the exception of accounts receivable/payable generated from the Service agreement, no intercorporate debt will exist between DP and Domestic Controlled at the time of, or subsequent to, the DP Distribution.
- n. Immediately before the DP Distribution, 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 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, DP will not have an excess loss account with respect to the Domestic Controlled stock; therefore, it will not be included in income immediately before the distribution. (See §1.1502-19).
- o. Payments made in connection will all continuing transactions, if any, between DP and Domestic Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's

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length.

- p. No two parties to the transaction are investment companies as defined in sections 368(a)(2)(F)(iii) and (iv).
- q. The DP Distribution is not part of a "plan or series of related transactions" (within the meaning of section 355(e)) pursuant to which one or more persons, other than FP, will acquire directly or indirectly stock possessing 50 percent or more the total combined voting power of all classes of stock of either DP or Domestic Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either DP or Domestic Controlled.
- r. The indebtedness owned by Foreign Controlled, if any, to FP after the FP Distribution of the Foreign Controlled stock will not constitute stock or securities.
- s. The retained stock, options, and any stock acquired upon exercise of the options will be disposed of as soon as a disposition is warranted consistent with the business purpose specified above, but in any event, not later than five years after the distribution.
- t. FP will refrain from voting on the retained stock in Foreign Controlled.
- u. No part of the consideration to be distributed by FP will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- v. The five years of financial information submitted on behalf of FP is representative of the corporation's present operation, and with regard to the corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- w. The five years of financial information submitted on behalf of Foreign Controlled is representative of the corporation's present operations and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- x. Following the transaction, FP and Foreign Controlled will continue the active conduct of its business, independently and with its separate employees.
- y. The distribution of the stock of Foreign Controlled by FP is carried out for

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the following corporate business purposes: offering of shares in a publicly traded Y Business to senior management of the Y Business and attracting industry expert corporate directors. The FP Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.

- z. There is no plan or intention by any shareholder who owns 5% or more of FP, except for Pension Fund, to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either FP or Foreign Controlled after the transaction.

Pension Fund is a Country pension fund that is not subject to U.S. income taxation.

- aa. There is no plan or intention by either FP or Foreign 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.
- bb. There is no plan or intention to liquidate either FP or Foreign Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the FP Distribution, except in the ordinary course of business.
- cc. For purposes of section 355(d), immediately after the FP Distribution, no person will hold disqualified stock (under section 355(d)(3)) in FP or Foreign Controlled possessing 50 percent or more of the total combined voting power of all classes of FP or Foreign Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of FP or Foreign Controlled stock.
- dd. The total adjusted bases and the fair market value of the assets transferred to Foreign Controlled by FP each equals or exceeds the sum of the liabilities assumed by Foreign Controlled plus any liabilities to which the transferred assets are subject; and the liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- ee. FP neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the FP Distribution.
- ff. Payments made in connection with all continuing transactions, if any, between FP and Foreign Controlled, will be for fair market value based on

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terms and conditions arrived at by the parties bargaining at arm's length.

- gg. No two parties to the FP Distribution are investment companies as defined in sections 368(a)(2)(F)(iii) and (iv).
- hh. The FP Distribution is not part of a "plan or series of related transactions" (within the meaning of section 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 either FP or Foreign Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either FP or Foreign Controlled.
- ii. DP will not contribute cash or other liquid or inactive assets to Domestic Controlled. Rather, DP will only contribute the stock of Sub 1, Sub 2, and Sub 3 to Domestic Controlled in the section 368(a)(1)(D) reorganization.
- jj. With the exception of cash needed in the daily operations of Foreign Controlled's business, FP will not contribute cash or other liquid or inactive assets to Foreign Controlled. Rather, FP will mainly contribute the stock of Domestic Controlled and other Y Business assets (including the stock of foreign Y Business subsidiaries) to Foreign Controlled in the section 368(a)(1)(D) reorganization.
- kk. The fair market value of the assets used in the active trade and business of Sub 1 comprises greater than 5 percent of the fair market value of the gross assets for Sub 1.
- ll. The fair market value of the assets used in the active trade and business of Sub 2 comprises greater than 5 percent of the fair market value of the gross assets for Sub 2.
- mm. The fair market value of the assets used in the active trade and business of Sub 4 comprises greater than 5 percent of the fair market value of the gross assets for Sub 4.
- nn. Sub 3 will have been a controlled foreign corporation ("CFC"), within the meaning of § 957(a), at all times during the five-year period ending on the date of the DP Contribution and will be a CFC immediately thereafter.
- oo. Neither DP nor Domestic Controlled has been or will be a "United States real property holding corporation" ("USRPHC"), as defined in § 897(c)(2), at any time during the 5-year period ending on the date of the DP Distribution, and neither DP nor Domestic Controlled will be a USRPHC immediately after the DP Distribution.

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- pp. Neither FP, nor Foreign Controlled will be a CFC, within the meaning of § 957(a), at any time during the 5-year period ending on the date of the FP Distribution and neither FP, nor Foreign Controlled will be a CFC immediately after the FP Distribution.
- qq. Neither FP, nor Foreign Controlled will be a passive foreign investment company ("PFIC"), within the meaning of § 1297(a), at any time during the 5-year period ending on the date of the FP Distribution and neither FP, nor Foreign Controlled will be a PFIC immediately after the FP Distribution.
- rr. In connection with the transactions contemplated in the ruling request, neither DP, Domestic Controlled, nor their respective domestic subsidiaries will transfer property, directly or indirectly, to any foreign corporation in an exchange described in § 367(a).
- ss. In connection with the transactions contemplated in the ruling request, neither DP, Domestic Controlled, nor their respective domestic subsidiaries will transfer property, directly or indirectly, to any foreign corporation in an exchange described in § 367(d).
- tt. In connection with the transactions contemplated in the ruling request, neither DP, Domestic Controlled, nor their respective domestic subsidiaries will transfer property to a foreign partnership that would be subject to the reporting requirements of § 6038B.
- uu. Neither FP nor any of its domestic or foreign subsidiaries will license any property to Domestic Controlled and/or any of its domestic or foreign subsidiaries. Neither Domestic Controlled nor any of its domestic or foreign subsidiaries will license property to FP and/or any of its domestic subsidiaries. Neither Domestic Controlled and/or any of its domestic subsidiaries will enter into license agreements for property rights with its foreign subsidiary.
- vv. FP will not license any intangible assets it purchased on Date 2 back to DP, Domestic Controlled, or their respective domestic subsidiaries.

Based solely on the information submitted and the representations set forth above, with regards to the DP Contribution and DP Distribution, we rule as follows:

1. The transfer by DP to Domestic Controlled of the DP Y Business Subsidiaries in exchange for the stock of Domestic Controlled, and the assumption by Domestic Controlled of DP liabilities (if any), followed by the DP Distribution, will be a reorganization within the meaning of section 368(a)(1)(D) of the Code. DP and Domestic Controlled will each be "a

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party to a reorganization" within the meaning of section 368(b).

2. No gain or loss will be recognized by DP on the DP Contribution in exchange for Domestic Controlled stock and the assumption by Domestic Controlled of DP liabilities (if any). Sections 361(a) and 357(a).
3. No gain or loss will be recognized by Domestic Controlled upon receipt of the stock in the Y Business Subsidiaries from DP in exchange for Domestic Controlled common stock. Section 1032(a).
4. The basis of each asset received by Domestic Controlled will equal the basis of that asset in the hands of DP immediately before the DP Contribution. Section 362(b).
5. The holding period of each asset received by Domestic Controlled in the DP Contribution will include the period during which that asset was held by DP. Section 1223(2).
6. If DP recognizes no gain under § 1248 by reason of the contribution of the stock of Sub 3 to the capital of Domestic Controlled, the earnings and profits of Sub 3 to the extent attributable to such stock under §§ 1.1248-2 or 1.1248-3 of the Income Tax Regulations (whichever is applicable), which were accumulated in taxable years of such corporation beginning after December 31, 1962 and during the period in which Sub 3 was a controlled foreign corporation, shall be attributable to such stock now held by Domestic Controlled (see § 1.1248-1(a)(1)).
7. No gain or loss will be recognized by (and no amount will otherwise be included in the income of) FP on its receipt of the Domestic Controlled stock in the DP Distribution, as described above. Section 355(a)(1).
8. No gain or loss will be recognized by DP on the distribution of Domestic Controlled's stock to FP in the DP Distribution. Sections 361(c) and 1.367(e)-1(c).
9. The aggregate basis of the stock of DP and Domestic Controlled in the hands of FP after the DP Distribution will equal the aggregate basis of the DP stock in the hands of FP immediately before the DP Distribution (Section 358(a) and Section 1.358-1(a)). Such basis will be allocated between the DP stock and the Domestic Controlled stock in proportion to the fair market value of each in accordance with Section 1.358-2(a)(2). Sections 358(b)(2) and 358(c).
10. The holding period of the Domestic Controlled stock received by FP will include the holding period of the DP stock on which the DP Distribution is

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made, provided FP held the DP stock as a capital asset on the date of the DP Distribution. Section 1223(1).

11. As provided in section 312(h), proper allocation of earnings and profits between DP and Domestic Controlled will be made under sections 1.312-10(a) and 1.1502-33 of the regulations.

With regard to the FP Contribution and the FP Distribution (the demerger transaction), we rule as follows:

12. For federal income tax purposes, the demerger transaction, as described above, will be treated as if (i) FP formed Foreign Controlled, (ii) FP transferred its Y Business assets (which include its Y Business Subsidiaries and operating assets) to Foreign Controlled in exchange for all of the stock of Foreign Controlled and the assumption by Foreign Controlled of related liabilities, and (iii) FP distributed to its shareholders stock of Foreign Controlled (cf. Rev. Rul. 77-191, 1977-1 C.B. 94).
13. The transfer by FP to Foreign Controlled of the assets of FP's Y Business in exchange for the stock of Foreign Controlled, and the assumption by Foreign Controlled of FP liabilities, followed by the FP Distribution, will be a reorganization within the meaning of Section 368(a)(1)(D). FP and Foreign Controlled will each be "a party to a reorganization" within the meaning of Section 368(b).
14. No gain or loss will be recognized by FP on the FP Contribution in constructive exchange for Foreign Controlled stock and the assumption by Foreign Controlled of FP liabilities. Sections 361(a) and 357(a).
15. No gain or loss will be recognized by Foreign Controlled on the receipt of the FP Contribution in constructive exchange for Foreign Controlled stock. Section 1032(a).
16. The basis of each asset received by Foreign Controlled will equal the basis of that asset in the hands of FP immediately before the FP Contribution. Section 362(b).
17. The holding period of each asset received by Foreign Controlled in the FP Contribution will include the period during which that asset was held by FP. Section 1223(2).
18. No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the FP shareholders on their receipt of the Foreign Controlled stock in the FP Distribution. Section 355(a)(1).

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19. No gain or loss will be recognized by FP on the distribution of Foreign Controlled's stock to the FP shareholders in the FP Distribution. Section 361(c).
20. The aggregate basis of the stock of FP and Foreign Controlled in the hands of the FP shareholders after the FP Distribution will equal the aggregate basis of the FP stock in the hands of the FP shareholders immediately before the FP Distribution (Section 358(a) and Section 1.358-1(a)). Such basis will be allocated between the FP stock and the Foreign Controlled stock in proportion to the fair market value of each in accordance with section 1.358-2(a)(2). Sections 358(b)(2) and 358(c).
21. The holding period of the Foreign Controlled stock received by the FP shareholders will include the holding period of the FP stock on which the FP Distribution is made, provided the FP shareholders hold the FP stock as a capital asset on the date of the FP Distribution. Section 1223(l).
22. As provided by section 312(h), proper allocation of earnings and profits between FP and Foreign Controlled will be made under section 1.312-10(a) of the regulations.

Except as specifically ruled above, no opinion is expressed concerning the federal income tax consequences of the transactions described above. Specifically, no opinion is expressed regarding the following:

- a. Whether the transaction involving the transfer of intangibles by DP to FP (i) constitutes a sale for U.S. federal income tax purposes, or (ii) was for fair market value for purposes of § 482.
- b. The applicability of any transfer pricing issues under § 482 in connection with the remaining transactions contemplated in the Ruling Request.
- c. Whether any or all of the above-referenced foreign corporations 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 corporations, no opinion is expressed with respect to the application of §§ 1291 through 1298 to the proposed transactions. 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.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the

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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.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,
Jasper L. Cummings
Associate Chief Counsel
By: Lewis K Brickates
Assistant to the Branch Chief