

INTERNAL REVENUE SERVICE

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Parent =

Target 1 =

Target 2 =

Newco =

Country A =

State B =

Business C =

D =

E =

Date F =

G =

H =

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This letter responds to your request dated February 22, 1999, for rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated April 16, 1999 and June 25, 1999. The information submitted for consideration is summarized below.

Parent, a Country A corporation, owns all of the outstanding stock of Target 1. Target 1, a State B corporation, is a holding company and a "dual resident corporation" subject to § 1503(d) of the Internal Revenue Code.

Target 1 owns all of the outstanding stock of Target 2. Target 2, a State B corporation, is a holding company and a dual resident corporation subject to § 1503(d). Target 2 owns the stock of various United States subsidiaries (the "Subs") engaged in Business C.

Target 1, Target 2 and the Subs are all members of a United States consolidated group (with Target 1 as the common parent) that files an accrual basis consolidated federal income tax return on a 52/53 week period ending on H.

Parent wishes to simplify the existing United States corporate structure by replacing Target 1 and Target 2, the dual resident holding companies, with a newly incorporated State B holding company, Newco, which will be managed in the United States. To achieve this business purpose, the Target 1 consolidated group proposes to enter into the following series of transactions, which are structured to satisfy Country A tax and regulatory requirements:

- (i) Target 1 will sell all of its outstanding common shares of Target 2 to Parent for \$100;
- (ii) Target 1 will transfer substantially all of its assets to Target 2 in exchange for preferred stock of Target 2 equal to the book value of the net assets transferred and the assumption by Target 2 of liabilities of Target 1.
- (iii) Target 1 will be liquidated and all of the shares of preferred stock of Target 2 received in Step (ii) will be distributed to Parent;
- (iv) Target 2 will organize Newco, a State B corporation, and will transfer the stock of the Subs to Newco in exchange for Newco common stock;
- (v) Target 2 will sell the shares of common stock of Newco to Parent for cash equal to the shares' book value; and

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- (vi) Target 2 will be liquidated and all of the Newco stock received in Step (iv) and all of the cash received from Parent in Step (v) will be distributed to Parent, and Parent will assume the liabilities of Target 2, which consist of the liabilities of Target 1 assumed by Target 2 in Step (ii). The liabilities that will be assumed by Parent are a \$D million liability of Target 1 (the "x liability") and a \$G thousand liability of Target 1 (the "y liability").

It is anticipated that all of the above steps will occur on the same day. As a result of Step (ii), \$E million of indebtedness created by a demand loan (the "Demand Loan") extended by Target 1 (the creditor) to Target 2 (the debtor) will be eliminated. The Demand Loan, which originated as an \$E million cash loan from Target 1 to Target 2 on Date F, is unsecured and non-interest bearing; the Demand Loan has been represented to constitute equity of Target 2.

Although the proposed transaction will be carried out in the manner described immediately above, it will be treated for federal income tax purposes as if the following steps are occurring:

- (A) Target 2 first distributes all of its assets and liabilities to Target 1 in complete liquidation of Target 2;
- (B) Parent then forms Newco;
- (C) Parent then assumes Target 1's x liability and y liability; and
- (D) Target 1 then transfers all of its assets (including the assets received from Target 2 in Step (A) above) to Newco solely in exchange for Newco stock, and then distributes the Newco stock to Parent in complete liquidation of Target 1.

With respect to the liquidation of Target 2 with and into Target 1 (Step (A) above), the taxpayers have made the following representations:

- (a) On the date of adoption of the plan of liquidation (such adoption treated as taking place immediately before Step (A) above), and at all times until the final liquidating distribution is completed (immediately after Step (A) above is completed), Target 1 will be the owner of at least 80 percent of the total combined voting power of all classes of stock of Target 2 entitled to vote and the owner of at least 80 percent of the total value of all classes of stock (excluding nonvoting stock that is limited and preferred as to dividends and otherwise meets the requirements of § 1504(a)(4) of the Code).
- (b) No shares of Target 2 stock will have been redeemed during the three years preceding the adoption of the plan of complete liquidation of Target 2.

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- (c) All distributions from Target 2 to Target 1 pursuant to the plan of complete liquidation will be made within a single taxable year of Target 2.
- (d) As soon as the first liquidating distribution has been made, Target 2 will cease to be a going concern and its activities will be limited to winding up its affairs, paying its debts, and distributing its remaining assets to Target 1.
- (e) Target 2 will retain no assets following the final liquidating distribution.
- (f) Target 2 will not have acquired assets in any nontaxable transaction at any time, except for acquisitions occurring more than three years prior to the date of adoption of the plan of liquidation.
- (g) No assets of Target 2 have been, or will be, disposed of by either Target 2 or Target 1, except for dispositions in the ordinary course of business and dispositions occurring more than three years prior to adoption of the plan of complete liquidation, other than the disposition that will take place in Step (D) above.
- (h) The complete liquidation of Target 2 will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation of any of the businesses or assets of Target 2, other than the transfer that will take place in Step (D) above.
- (i) Prior to the adoption of the plan of liquidation, no assets of Target 2 will have been distributed in kind, transferred, or sold to Target 1, except for (i) transactions occurring in the normal course of business and (ii) transactions occurring more than three years prior to the adoption of the plan of liquidation.
- (j) Target 2 will report all earned income, if any, represented by assets that will be distributed to Target 1, such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.
- (k) The fair market value of the assets of Target 2 will exceed its liabilities both at the date of the adoption of the plan of liquidation and immediately prior to the time the first liquidating distribution is made.
- (l) The only intercorporate debt existing between Target 1 and Target 2 immediately before Step A is the Demand Loan. Other than the Demand Loan, no intercorporate debt has been canceled, forgiven, or discounted except for transactions that occurred more than three years prior to the date of adoption of the plan of liquidation.
- (m) Target 1 is not an organization that is exempt from federal income tax under § 501 or any other provision of the Code.

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- (n) All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the proposed liquidation of Target 2 have been fully disclosed.

With respect to Steps (A) through (D) above, the taxpayers have made the following representation:

- (o) To the best of the knowledge and belief of the taxpayer, the portion of the transaction whereby Target 1 transfers all of its assets (including the assets received in complete liquidation of Target 2) to Newco, solely in exchange for Newco stock, followed by the complete liquidation of Target 1 into Parent (Step (D) above), will qualify as a reorganization under section 368(a)(1)(F), provided that for federal income tax purposes, the Internal Revenue Service rules that the complete liquidation of Target 2 into Target 1 in Step (A) above, the creation of Newco by Parent in Step (B) above, and the assumption by Parent of the x liability and the y liability of Target 1 in Step (C) above, will not disqualify what would have otherwise been a valid reorganization under section 368(a)(1)(F) if viewed as a separate transaction from Steps (A), (B), and (C).

With respect to the entire transaction, the taxpayers have made the following representations:

- (p) The Demand Loan is treated, for federal income tax purposes, as equity.
- (q) Both Target 1 and Target 2 are dual resident corporations.
- (r) The taxpayer has made no elections and filed no agreements under § 1.1503-2A(c)(3) or § 1.1503-2(g)(2) with respect to Target 1's and Target 2's dual consolidated losses, if any.
- (s) To the best of the knowledge of the taxpayer, neither Target 1's nor Target 2's dual consolidated losses, if any, have been used to offset the income of any domestic affiliate.
- (t) There is no plan or intention for Newco to be a dual resident corporation.

Based on the information submitted and on the representations set forth above, and provided that the Demand Loan is classified as equity for federal income tax purposes, we hold as follows:

- (1) For federal income tax purposes, the formal steps describing the proposed transaction in paragraphs (i) through (vi), above, including the circular movement of cash, will be disregarded and the transaction will be treated as if steps A, B, C, and D above are occurring.

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- (2) Step A above will qualify as a complete liquidation of Target 2 within the meaning of § 332. No gain or loss is recognized by Target 1 as a result of the receipt of the assets and liabilities of Target 2 in complete liquidation of Target 2 (§ 332(a)).
- (3) No gain or loss is recognized by Target 2 as a result of transferring its assets to Target 1 (§ 337(a)).
- (4) The basis of each asset received by Target 1 from Target 2 is equal to the basis of that asset in the hands of Target 2 immediately before such complete liquidation (§ 334(b)(1)).
- (5) The holding period of each asset received by Target 1 from Target 2 includes the period during which that asset was held by Target 2 prior to such complete liquidation (§ 1223(2)).
- (6) Pursuant to section 381(a) and § 1.381(a)-1, Target 1 will succeed to and take into account the items of Target 2 described in § 381(c), including the earnings and profits, or deficit in earnings and profits, of Target 2 as of the date of the transfer. Any deficit in the earnings and profits of Target 1 or Target 2 will be used only to offset the earnings and profits accumulated after the date of transfer. These items will be taken into account by Target 1 subject to the conditions and limitations specified in §§ 381, 382, 383, and 384 and the regulations thereunder.
- (7) Steps (A), (B), and (C) will not prevent Step (D) from qualifying as a reorganization under § 368(a)(1)(F). *See, e.g.,* Rev. Rul. 58-422, 1958-2 C.B. 145.
- (8) Target 1's and Target 2's dual consolidated losses, if any, cannot be used to offset the income of Newco or the Subs (§§ 1.1503-2A(a) and 1.1503-2(b)(2)).

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. We specifically express no opinion as to whether the transfer of all of Target 1's assets to Newco constitutes a reorganization within the meaning of § 368(a)(1)(F) (section 3.01(27) of Rev. Proc. 99-3, 1999-1 I.R.B. 103, 107), or whether the Demand Loan is properly classified as debt or equity for federal income tax purposes (section 4.02(1) of Rev. Proc. 99-3, 1999-1 I.R.B. 103, 111).

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.

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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, we have sent a copy of this letter to the taxpayer.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Michael J. Wilder

Michael J. Wilder  
Assistant to the Chief, Branch 3