

Internal Revenue Service

Department of the Treasury

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Distributing =

S1 =

S2 =

S3 =

Year 1 =

Year 2 =

Year 3 =

Business A =

Business B =

We respond to your February 29, 2000 request for rulings on certain federal income tax consequences of a series of proposed transactions. The information submitted in that request and in later correspondence is summarized below. Distributing's predecessors received rulings on prior transactions during Year 1, Year 2, and Year 3 (the "Prior Ruling Letters").

The rulings in this letter are based on the facts and representations submitted under penalties of perjury in support of the request. Verification of that information may be required as part of the audit process.

Summary of Facts

Publicly traded Distributing is a holding company and the common parent of a consolidated group. Distributing wholly owns S1 and S2, and S1 wholly owns S3. S1 conducts Business A, S2 conducts Business B, and S3 owns branches and subsidiaries engaged in Business A and Business B.

We have received financial information indicating that Business A of S1, Business B of S2, and Business A of S3 each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

The operation of Business A and Business B within the same affiliated group creates managerial, systemic, and other problems and produces no significant synergies. Distributing's management has therefore decided, based on the advice of consultants and on other information, that the two businesses should be separated.

Proposed Transactions

To accomplish this separation, Distributing proposes the following transactions:

(i) Certain subsidiaries of S3 engaged in Business B will be distributed from S3 to S1 and from S1 to Distributing.

(ii) Any intercompany accounts between the two groups of companies that will be members of different public groups following proposed Distribution 2 (defined below in step (viii)) will be eliminated through dividends, capital contributions, or payments, as appropriate, so that there will be no indebtedness between the two groups of companies following the proposed transactions.

(iii) Distributing will incorporate Controlled as a wholly owned domestic subsidiary.

(iv) Controlled will incorporate a wholly owned domestic subsidiary ("Transitory").

(v) Transitory will merge with and into S1, with S1 surviving. In the merger, Distributing will receive additional shares of Controlled stock, and S1 will become a wholly owned subsidiary of Controlled. The S1 stock will be transferred to Controlled in this manner to avoid certain corporate law problems associated with a direct contribution of the S1 stock to Controlled.

(vi) S1 will distribute the S3 stock to Controlled ("Distribution 1").

(vii) Distributing will contribute cash, together with any remaining non-Business B assets, to Controlled, and Controlled will assume certain non-Business B liabilities and contingent obligations of Distributing. Steps (iii) through (v) and (vii) will be referred to collectively hereinafter as the "Contribution."

(viii) Distributing will distribute the Controlled stock pro rata to the Distributing shareholders ("Distribution 2"). In lieu of fractional Controlled shares,

the distribution agent will aggregate and sell the fractional interests and remit the proceeds to the shareholders entitled thereto.

(ix) Distributing and Controlled will change their names to reflect the new business configurations.

Representations

Distribution 1

The taxpayers have made the following representations concerning proposed Distribution 1:

(a) No part of the S3 stock distributed by S1 will be received by Controlled as a creditor, employee, or in any capacity other than that of a shareholder of S1.

(b) The five years of financial information submitted for S1 and S3 represents the present business operations of S1 and S3, and regarding each business, there have been no substantial operational changes since the date of the last financial statements submitted.

(c) Following Distribution 1, S1 and S3 each will continue the active conduct of its business, independently and with its separate employees.

(d) Distribution 1 is being undertaken to resolve managerial, systemic, and other problems that have arisen from operating Business A and Business B within a single affiliated group. Distribution 1 is motivated, in whole or substantial part, by this corporate business purpose and for other business reasons.

(e) There is no plan or intention by Controlled to sell, exchange, transfer by gift, or otherwise dispose of any stock in either S1 or S3 after Distribution 1.

(f) There is no plan or intention by S1 or S3, directly or through any subsidiary corporation, to purchase any of its outstanding stock after Distribution 1.

(g) There is no plan or intention to liquidate S1 or S3, to merge either corporation with any other corporation, or to sell or otherwise dispose of any of the assets of either corporation after Distribution 1, except in the ordinary course of business.

(h) Any indebtedness owed by S3 to S1 after Distribution 1 will not be stock or securities.

(i) Immediately before Distribution 2, any 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 of the Income Tax

Regulations as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597).

(j) Payments made in any continuing transactions between S1 and S3 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(k) Distribution 1 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 either S1 or S3 stock entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either S1 or S3.

Contribution and Distribution 2

Distributing has made the following representations concerning proposed Contribution and Distribution 2:

(l) No part of the Controlled stock distributed by Distributing will be received by a shareholder of Distributing as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(m) The five years of financial information submitted for S1 and S2 represents the present business operations of S1 and S2, and regarding each business, there have been no substantial operational changes since the date of the last financial statements submitted.

(n) Immediately after Distribution 2, 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 (S2 for Distributing; S1 and S3 for Controlled) that are engaged in the active conduct of a trade or business as defined in § 355(b)(2). Each such controlled corporation will continue the active conduct of its business, independently and with its separate employees.

(o) Distribution 2 is being undertaken to resolve managerial, systemic, and other problems that have arisen from operating Business A and Business B within a single affiliated group. Distribution 2 is motivated, in whole or substantial part, by this corporate business purpose and for other business reasons.

(p) There is no plan or intention by any shareholder who owns five percent or more of the Distributing stock, 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 either Distributing or Controlled after Distribution 2.

(q) There is no plan or intention to liquidate either Distributing or Controlled, to

merge either corporation with any other corporation, or to sell or otherwise dispose of any of the assets of either corporation after Distribution 2, except in the ordinary course of business.

(r) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing in the Contribution will, in each instance, equal or exceed the liabilities assumed (as determined under § 357(d)) by Controlled.

(s) The liabilities assumed (as determined under § 357(d)) in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.

(t) None of the transferred assets will include property that will be subject to investment tax credit recapture.

(u) Any indebtedness owed by Controlled to Distributing after Distribution 2 will not be stock or securities.

(v) Immediately before Distribution 2, 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 and as currently in effect; § 1.1502-13 as published by T.D. 8597). Any excess loss account Distributing may have in the stock of Controlled, and any excess loss account of any corporation that will leave the Distributing consolidated group in the proposed transactions, will be taken into account as required by applicable regulations (see § 1.1502-19)

(w) Payments made in connection with any continuing transactions between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(x) No two parties to the transactions are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(y) 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 Distribution 2, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

(z) Distribution 2 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 either Distributing or Controlled entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

(aa) For purposes of § 355(d), immediately after Distribution 2, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of Distribution 2.

(bb) For purposes of § 355(d), immediately after Distribution 2, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of Distribution 2 or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of Distribution 2.

(cc) Distributing and Controlled will each pay its own expenses, if any, incurred in connection with the transactions.

Rulings

Distribution 1

Based solely on the information submitted and the representations set forth above, we rule as follows on proposed Distribution 1:

(1) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Controlled on Distribution 1 (§ 355(a)(1)).

(2) No gain or loss will be recognized by S1 on Distribution 1 (§ 355(c)).

(3) The holding period of the S3 stock received by Controlled in Distribution 1 will include the holding period of the S1 stock on which Distribution 1 is made, provided the S1 stock is held as a capital asset on the date of Distribution 1 (§ 1223(1)).

(4) Earnings and profits will be allocated between S1 and S3 in accordance with §§ 312(h), 1.312-10(b), and 1.1502-33(f)(2).

Contribution and Distribution 2

Based solely on the information submitted and the representations set forth above, we rule as follows on proposed Contribution and Distribution 2:

(5) For federal income tax purposes, the proposed transaction described in steps (iii) through (v) and (vii) will be treated as if Distributing had transferred assets,

including the stock of S1, to Controlled in exchange for the stock of Controlled and the assumption by Controlled of related liabilities (the "Contribution").

(6) The Contribution, followed by Distribution 2, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under § 368(b).

(7) No gain or loss will be recognized by Distributing on the Contribution (§§ 357(a) and 361(a)).

(8) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).

(9) The basis of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).

(10) The holding period of each asset received by Controlled from Distributing in the Contribution will include the period during which that asset was held by Distributing (§ 1223(2)).

(11) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholders on Distribution 2 (§ 355(a)(1)).

(12) No gain or loss will be recognized by Distributing on Distribution 2 (§ 361(c)).

(13) The basis of the stock of Distributing and Controlled in the hands of each Distributing shareholder after Distribution 2 (including any fractional share interests to which the shareholder may be entitled) will equal the aggregate basis of the Distributing stock in the hands of the Distributing shareholder immediately before Distribution 2 (§§ 358(a) and 1.358-1(a)). This basis will be allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§§ 358(b)(2) and 358(c)).

(14) The holding period of the Controlled stock received by each Distributing shareholder in Distribution 2 will include the holding period of the Distributing stock on which Distribution 2 is made, provided the Distributing stock is held as a capital asset on the date of Distribution 2 (§ 1223(1)).

(15) If cash is received by a Distributing shareholder in lieu of a fractional share of stock of Controlled, gain or loss will be recognized by the shareholder measured by the difference between the basis of the fractional share interest, as determined in ruling (13) above, and the amount of cash received. If the fractional share qualifies as a capital asset in the hands of the shareholder, the gain or loss will be a capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code (§§ 1221 and 1222).

(16) Earnings and profits will be allocated between Distributing and Controlled in accordance with §§ 312(h), 1.312-10(a), and 1.1502-33(e)(3).

(17) The proposed transactions will not adversely affect the Prior Ruling Letters, which will retain full force and effect.

Caveats

We express no opinion on the tax effects of the transactions under any other provisions of the Code or regulations, or the tax effects of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the rulings. In particular, no opinion was requested and we express no opinion on the tax effects of steps (i) (the distribution of certain S3 subsidiaries), (ii) (the elimination of intercompany accounts), and (ix) (the name changes).

Procedural Statements

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

A copy of this letter must be attached to the federal income tax return of each taxpayer involved for the taxable year in which the proposed transactions are completed.

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

Sincerely,
Assistant Chief Counsel (Corporate)
By: Wayne T. Murray
Senior Technician/Reviewer
Branch 4