

Internal Revenue Service

Department of the Treasury

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Date:

June 15, 1999

Distributing 2 =

Distributing 1 =

Distribution 1 =

Distribution 2 =

Target =

Target-Sub =

Controlled =

Subsidiary =

State X =

Business A =

Business B =

Date 1 =

a =

Dear :

This responds to your letter dated October 2, 1998, in which you requested rulings on behalf of the above-captioned taxpayers. Specifically, you requested rulings under § 355 of the Internal Revenue Code. Additional information regarding your request has been submitted in letters dated December 16, 1998; December 21, 1998; January, 13, 1999; March 17, 1999; and March 30, 1999. The information submitted for our review is summarized below.

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 material submitted in support of the request for rulings. Verification of the factual information, representations, and other data may be required as part of the audit process.

Distributing 2, a State X corporation, is engaged directly and through subsidiaries in two lines of business: Business A and Business B. Both businesses have been conducted for more than five years. Distributing 2 files its federal income tax returns on a consolidated basis and uses the accrual method of accounting. Distributing 2's current capital structure consists of outstanding common stock which is widely-held and publicly traded.

Distributing 1 is wholly-owned by Distributing 2 and has been engaged in Business B for more than five years. Over the past few years, the business of Distributing 1 has been expanded through the purchase of other entities engaged in the same line of business as Distributing 1. These acquisitions have been accomplished mostly through acquisitions by newly-created subsidiaries of Distributing 1

On Date 1, Distributing 1 acquired the assets of Target and Target-Sub through the following transaction. Distributing 1 created two new subsidiaries, Subsidiary and Controlled. Distributing 2 paid cash to the parent of Target for the assets of both Target and Target-Sub. The assets of Target were then transferred to Subsidiary, and the assets of Target-Sub were transferred to Controlled in a transaction represented to qualify under § 351. Prior to and following its acquisition, Target-Sub has been engaged in the installation of the types of products manufactured by Distributing 1. Also, prior to the acquisition of the Target-Sub assets, neither Distributing 1 nor Distributing 2 had been engaged in the installation of their products.

Following the acquisition of the Target-Sub assets, a number of customers of Distributing 1 which are engaged in the installation of the types of products

manufactured by Distributing 1 have threatened to quit buying products from Distributing 1 unless the distributing group divests itself of Controlled, a direct competitor of these customers. The taxpayer has submitted information indicating that the potential loss of income from losing those customers is significant.

In order to avoid this loss of income, the taxpayer proposes to engage in the following transaction. First, Controlled will engage in an Initial Public Offering in which it will sell no more than a% of its stock. Distributing 1 will then distribute all of its stock interest (at least 80%) in Controlled to Distributing 2 which will then distribute all of the stock received pro rata to its shareholders.

The taxpayer has supplied financial information which indicates that Distributing 1 and Distributing 2 has each been conducting a business that has had gross receipts and operating expenses representative of the active conduct of such business for each of the past five years. Controlled conducts the same business (Business B) as Distributing 2.

Controlled currently purchases products from Distributing 1 in the ordinary course of its business and expects to continue purchasing such products. Distributing 1 will also be providing certain administrative services to Controlled until such time as Controlled has the internal staff and expertise to perform those services.

The following additional representations have been made in connection with the transaction:

- (a) No part of the consideration to be distributed by Distributing 1 or Distributing 2 will be received by any shareholder of Distributing 1 or Distributing 2 as a creditor, employee, or in any capacity other than that of a shareholder of Distributing 1 or Distributing 2.
- (b) The 5 years of financial information with respect to Business A and Business B is representative of Distributing 2's and Distributing 1's present operations, respectively, and, with regard to such corporations, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the distribution, Distributing 1 and Controlled each will continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of Business B conducted by Distributing 1 and Controlled prior to consummation of the distribution of Controlled. Following that distribution, Distributing 2 will continue Business A independently and with its own separate employees
- (d) The distribution of Controlled is being carried for the corporate business purpose

of resolving Distributing 1's problems with a substantial segment of its Business B customers who object to the distributing group engaging, through Controlled, in the installation of its products in competition with such customers. The distribution is wholly motivated by this corporate business purpose.

- (e) There is no plan or intention by Distributing 2, the sole shareholder of Distributing 1, or by any security holder of Distributing 1, to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Distributing 1 or Controlled after the distribution of Controlled stock, except for the Controlled stock received by Distributing 2 that will be distributed to Distributing 2's shareholders.
- (f) There is no plan or intention by any shareholder who owns 5% or more of the Distributing 2 stock and the management of Distributing 2 is not aware of any plan or intention on the part of any particular remaining shareholder or security holder of Distributing 2 to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing 2 or Controlled after the distribution of Controlled stock.
- (g) There is no plan or intention by either Distributing 1, Distributing 2 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 § 4.05(1)(b) of Rev. Proc. 96-30.
- (h) There is no plan or intention to liquidate Distributing 2, Distributing 1 or Controlled, to merge Distributing 2, Distributing 1 or Controlled with any other corporation or to sell or otherwise dispose of the assets of Distributing 2, Distributing 1 or Controlled after the distribution of Controlled, except in the ordinary course of business.
- (i) No intercorporate debt will exist between Distributing 2, Distributing 1 and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (j) Payments in connection with all continuing transactions, if any, between Distributing 1, Distributing 2 and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (k) Immediately before the distribution of the Controlled stock, 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). Further, any excess loss account with respect to Controlled stock will be included in income immediately before the distribution (See § 1.1502-19).

- (l) Neither Distribution 1 nor Distribution 2 will be a disqualified distribution within the meaning of § 355(d)(2).
- (m) The 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 Distributing 1, Distributing 2 or Controlled or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.
- (n) The gross assets of the trades or businesses relied on to satisfy the active trade or business requirement of § 355(b) for the distribution of Controlled will have a fair market value that is at least 5 percent of the total fair market value of the gross assets of each such corporation directly conducting the trades or businesses.
- (o) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

Based solely on the information submitted and the representations made, we rule as follows:

- (1) Under § 1.355-3(b)(3)(ii), the installation business conducted by Controlled will be treated as an expansion business and, thus, as having been conducted for more than five years as part of the Business B activities of Distributing 1.
- (2) Distributing 1 will recognize no gain or loss upon the distribution of the Controlled stock in Distribution 1. Section 355(c)(1).
- (3) Distributing 2 will recognize no gain or loss (and no amount will be included in the income of Distributing 2) upon receipt of the Controlled stock in Distributing 1. Section 355(a)(1).
- (4) Distributing 2 will recognize no gain or loss upon distribution of the Controlled stock in Distribution 2. Section 355(c)(1).
- (5) No gain or loss will be recognized by the shareholders of Distributing 2 (and no income will be included in the income of the Distributing 2 shareholders) upon receipt of the Controlled stock in Distribution 2. Section 355(a)(1).
- (6) The aggregate basis of the Controlled stock and the Distributing 2 stock in the hands of each Distributing 2 shareholder after the distribution of Controlled stock (Distribution 2) will equal the Distributing 2 shareholder's basis in his or her

Distributing 2 stock held immediately before the distribution allocated to the Distributing 2 stock and the Controlled stock in proportion to the relative fair market value of each in accordance with § 1.358-2(a)(2). Section 358(a)(1).

- (7) Under § 1223(1), each Distributing 2 shareholder's holding period of the Controlled stock received in the distribution will include such shareholder's holding period of the Distributing 2 stock treated as being surrendered in exchange for the Controlled stock under § 1223(1), provided that such shareholder holds the Distributing 2 stock as a capital asset on the date of the distribution.
- (8) As provided in § 312(h), proper allocation of earnings and profits between Distributing 1 and Controlled (following Distribution 1) and between Distributing 2 and Controlled (following Distribution 2) will be made under § 1.312-10(a) .

No opinion is expressed about the tax treatment of the proposed 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 proposed transactions that are not specifically covered by the above rulings.

Temporary or final regulations pertaining to one or more of the issues addressed in this letter ruling (including regulations under § 358(g)) have not been adopted. Therefore, this ruling will be modified or revoked if adopted temporary or final regulations are inconsistent with any conclusions in this letter ruling. See § 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 47-48. However, when the criteria in § 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

This ruling is directed only to the taxpayer who requested it. Section 6610(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 returns of the taxpayers involved for the taxable year in which the transactions covered by this ruling is consummated.

Sincerely Yours,

Assistant Chief Counsel (Corporate)

By _____
Alfred C. Bishop
Chief, CC:DOM:CORP:1