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Department of the Treasury

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Person to Contact:

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Refer Reply To:

CC:CORP:6-PLR-147900-01

Date:

January 10, 2002

Legend:

CommonParent =

Distributing1 =

Distributing2 =

Controlled1 =

Controlled2 =

Subsidiary1 =

Subsidiary2 =

Subsidiary3 =

StateA =

StateB =

StateC =

StateAgencyA =

FederalAgencyA =

FederalAgencyB =

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BusinessA =

BusinessB =

BusinessBActivity =

AssetsA =

AssetsB =

OrganizationA =

OrganizationB =

\$aa =

\$bb =

\$cc =

DateA =

DateB =

DateC =

Year1 =

Year2 =

Year3 =

Chapter #XYZ =

Title #CCC =

Section #A&A =

Section #B&B =

Dear

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This is in response to your authorized representative's letter dated September 7, 2001, requesting rulings under section 355 of the Internal Revenue Code (the "Code") with respect to a proposed series of transactions (the "Ruling Request"). Additional information was received in subsequent letters submitted by mail and facsimile.

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.

SUMMARY OF FACTS

CommonParent, a StateA corporation, is the common parent of a consolidated group. CommonParent is a public utility holding company and owns, directly or indirectly, all or substantially all of the outstanding stock of domestic electric utility subsidiaries and other subsidiaries. CommonParent's common stock is publicly traded. Two of CommonParent's domestic electric utility subsidiaries, Distributing1 and Distributing2 (sometimes referred to herein collectively as "the Distributing Corporations"), are the subject of this letter ruling.

As of the date of the Ruling Request, CommonParent owns 100% of the common stock of Distributing1, a StateB corporation. CommonParent's stock ownership represents 100% of the voting power of Distributing1. CommonParent has owned 100% of the outstanding common stock of Distributing1 for more than five years. Distributing1 has outstanding shares of cumulative preferred stock, the holders of which are not entitled to vote for the election of directors.

As of the date of the Ruling Request, CommonParent owns 100% of the common stock of Distributing2, a StateB corporation. CommonParent's stock ownership represents 99.6% of the voting power of Distributing2. CommonParent has owned such stock of Distributing2 for more than five years. Distributing2 has outstanding shares of cumulative preferred stock, certain classes of which entitle the holders to vote for the election of directors.

The outstanding series of cumulative preferred stock of Distributing1 and Distributing2 represent less than 5% of the vote and less than 5% of the value of each of Distributing1 and Distributing2, respectively.

Distributing1 and Distributing2 is each a vertically-integrated electric utility that provides service to customers in parts of StateB. Distributing1 and Distributing2 are subject to regulation in StateB by StateAgencyA, as well as by several Federal agencies, including FederalAgencyA and FederalAgencyB. Distributing1 and Distributing2 currently use the accrual method of accounting.

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CommonParent also owns 100% of the outstanding stock of Subsidiary1, a StateA corporation, which provides various services at cost to CommonParent, Distributing1, Distributing2, and other subsidiaries of CommonParent. Subsidiary2 is an existing first-tier subsidiary of CommonParent. Subsidiary2 was incorporated on DateA in StateC. On DateB, CommonParent acquired 100% of the outstanding stock of Subsidiary2 in a tax-free reorganization.

Distributing1 currently is directly engaged in BusinessA and BusinessB in StateB. Distributing1 began BusinessA and BusinessB in Year1 (more than five years preceding the date of the Ruling Request) and has been continuously engaged in such businesses since that time.

Distributing2 currently is also directly engaged in BusinessA and BusinessB in StateB. Distributing2 began BusinessA and BusinessB in Year2 (more than five years preceding the date of the Ruling Request) and has been continuously engaged in such businesses since that time.

BusinessB has AssetsA and AssetsB. Distributing1 and Distributing2 currently own and operate their respective AssetsB. Pursuant to a FederalAgencyA Opinion pertaining to a prior transaction, OrganizationB performs certain functions with respect to the AssetsA of Distributing1 and Distributing2. However, each of Distributing1 and Distributing2 currently owns their respective AssetsA and performs active and substantial management functions with respect to their respective AssetsA.

In order to meet the requirements set forth in Chapter #XYZ to Title #CCC of the StateB statutory law (the "StateB Code"), in particular Section #A&A of the StateB Code, and to further the current business policies and objectives of CommonParent (as represented infra), the following transaction has been proposed:

(i) Distributing1 and Distributing2 will each form a wholly-owned corporation ("Controlled1" and "Controlled2", respectively, and sometimes referred to herein collectively as "the Controlled Corporations") and will contribute its BusinessB assets (AssetsA and AssetsB) to such subsidiary in exchange for 100% of the sole outstanding class of capital stock of such subsidiary (the "BusinessB Asset Drop-down").

(ii) Distributing1 will then distribute 100% of the outstanding capital stock of Controlled1 (the "Controlled1 Stock"), and Distributing2 will then distribute 100% of the outstanding capital stock of Controlled2 (the "Controlled2 Stock"), to CommonParent, the sole holder of each subsidiary's outstanding common stock (the "Spin-off"). It is the intention of CommonParent that the holders of the outstanding series of cumulative preferred stock in Distributing1 and Distributing2 will not participate in the Spin-off. Neither Distributing1 nor Distributing2 will retain any shares of the Controlled1 Stock or the Controlled2 Stock, respectively, following the Spin-off.

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(iii) CommonParent will then contribute all of the Controlled1 Stock and the Controlled2 Stock to Subsidiary2 (the “Subsidiary2 Stock Drop-down”).

Immediately following completion of the transactions described above, Subsidiary2 will form a first-tier wholly-owned limited liability company (“Subsidiary3”) under the laws of the State of StateB by contributing cash (in an amount to be determined) in exchange for 100% of the sole outstanding class of member interests in Subsidiary3. Controlled2 will then merge, pursuant to the laws of the State of StateB, into Subsidiary3 (the “Merger”), with Subsidiary3 as the surviving entity. Following the Merger, Subsidiary3 will continue to be a first-tier wholly-owned subsidiary of Subsidiary2. References herein to Controlled2 include Subsidiary3 where relevant.

Prior to the BusinessB Asset Drop-down, the Spin-off and the Subsidiary2 Stock Drop-down, CommonParent intends to cause Subsidiary2, directly or indirectly, to incur third-party debt, either through the capital markets or through borrowings with unrelated financial institutions, in the amount of approximately \$aa, which amount represents the sum of the outstanding indebtedness associated with the AssetsA and AssetsB being transferred by Distributing1 and Distributing2 to Controlled1 and Controlled2, respectively, in the BusinessB Asset Drop-down. CommonParent then intends to cause Subsidiary2 to dividend the approximately \$aa of third-party debt proceeds to CommonParent and CommonParent will contribute approximately \$bb of the proceeds to the capital of Distributing1 and approximately \$cc of the proceeds to the capital of Distributing2. Finally, CommonParent intends that Distributing1 and Distributing2 will use the proceeds to pay off the portion of the outstanding indebtedness (i.e., first mortgage bonds) associated with the AssetsA and AssetsB being transferred by Distributing1 and Distributing2 to Controlled1 and Controlled2, respectively, in the BusinessB Asset Drop-down. At this point, CommonParent will proceed with the BusinessB Asset Drop-down, the Spin-off and the Subsidiary2 Stock Drop-down, as outlined immediately above.

After the Spin-off and the Subsidiary2 Stock Drop-down, Distributing1, Distributing2, Controlled1, Controlled2, and Subsidiary2 will use the accrual method of accounting and will have a tax year ending DateC.

Following the Spin-off and the Subsidiary2 Stock Drop-down, Distributing1 and Distributing2 each will continue to be directly engaged in BusinessA (“the BusinessA Active Business”), and Subsidiary2, operating through Controlled1 and Controlled2, will be directly engaged in BusinessB (the “BusinessB Active Business”) in StateB. (Reference in representation (c), infra, to the Distributing1 Active Business is to the BusinessA Active Business as conducted by Distributing1, and reference to the Distributing2 Active Business is to the BusinessA Active Business as conducted by Distributing2).

Each of Controlled1 and Controlled2 will continue to own and actively operate its respective AssetsB, which assets will have a fair market value in excess of two-thirds of the total fair market value of the gross assets of each of Controlled1 and Controlled2,

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respectively, immediately after the Spin-off and the Subsidiary2 Stock Drop-down. Each of Controlled1 and Controlled2 also will own its respective AssetsA. However, in accordance with the requirements of certain FederalAgencyA Orders, Section #B&B of the StateB Code, and a FederalAgencyA Opinion pertaining to a prior transaction, CommonParent intends to transfer control with respect to certain functions, but not ownership, of the AssetsA held by its subsidiaries, including those assets to be held by Controlled1 and Controlled2 following the BusinessB Asset Drop-down, the Spin-off and the Subsidiary2 Stock Drop-down, to OrganizationA prior to the end of the second quarter of the Year3 calendar year. OrganizationA will assume the functions currently performed by the OrganizationB (as well as certain other additional functions) with respect to the AssetsA currently held by Distributing1 and Distributing2 that will be transferred to Controlled1 and Controlled2 in the BusinessB Asset Drop-down.

REPRESENTATIONS

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

- (a) The indebtedness, if any, owed by Controlled1 and Controlled2 to Distributing1 and Distributing2, respectively, after the distribution of the Controlled1 Stock and Controlled2 Stock will not constitute stock or securities.
- (b) No part of the Controlled1 Stock or the Controlled2 Stock to be distributed by Distributing1 and Distributing2 will be received by CommonParent as a creditor, employee, or in any capacity other than that of a shareholder of Distributing1 and Distributing2.
- (c) The five years of financial information submitted on behalf of the Distributing1 Active Business and the Distributing2 Active Business is representative of its present operations and 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 the BusinessB Active Business as conducted by each of Distributing1 and Distributing2 is representative of the present operations of each of Distributing1 and Distributing2 with regard to BusinessBActivity and there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the Spin-off, Distributing1, Distributing2, Controlled1 and Controlled2 will each continue the active conduct of its business, independently and with its separate employees.
- (f) The Spin-off is primarily being undertaken for regulatory reasons.

Specifically, the Spin-off allows CommonParent to comply with the requirements set forth in the StateB Code, the FederalAgencyA Orders, and the FederalAgencyA Opinion. The Spin-off is also being undertaken for the following corporate business purposes: (i) to provide for greater corporate and organizational separation of BusinessB from BusinessA, which will (a) provide investors with a clearer view of the value to be unlocked in each business, (b) foster accountability of each business, and (c) permit more efficient financing, all of which will result in enhanced efficiencies and economics; (ii) to focus management and technical expertise to maximize the potential growth of both regulated and non-regulated operations and to evaluate the performance of these separate businesses; (iii) to facilitate management's strategy to grow CommonParent's unregulated businesses, to evaluate other business opportunities, to explore ways to improve their results of operations, to continuously evaluate, and, where necessary, reshape CommonParent's business, and to grow earnings and improve shareholder value; and (iv) to allow CommonParent to conduct BusinessB separate and apart from BusinessA, in compliance with the separation requirements of federal and state restructuring legislation and codes of conduct, and to permit management to respond more efficiently to regulatory changes and new requirements brought on by deregulation. All of these corporate business purposes will permit CommonParent to effect fit and focus, within the meaning of Revenue Procedure 96-30, 1996-1 C.B. 696, with respect to its BusinessB. The Spin-off is motivated, in whole or substantial part, by all of these regulatory and corporate business purposes.

- (g) Other than (i) the transfer of the stock of Controlled1 and Controlled2 in the Subsidiary2 Stock Drop-down and (ii) the merger of Controlled2 with and into Subsidiary3, a wholly-owned first-tier limited liability company of Subsidiary2, there is no plan or intention by CommonParent to sell, exchange, transfer by gift, or otherwise dispose of any stock or securities in either Distributing1, Distributing2, Subsidiary2, Controlled2 or Controlled1 after the Spin-off.
- (h) Except for periodic sinking fund redemptions of shares of the outstanding cumulative preferred stock of Distributing1 and Distributing2, there is no plan or intention by Distributing1, Distributing2, Controlled1 and Controlled2, directly or through any subsidiary corporation, to purchase any of its outstanding stock, respectively, after the Spin-off, other than through stock purchases meeting the requirements of Section 4.05(1)(b) of Rev. Proc. 96-30.
- (i) Other than (i) the transfer of the stock of Controlled1 and Controlled2 in the Subsidiary2 Stock Drop-down and (ii) the merger of Controlled2 with and into Subsidiary3, a wholly-owned first-tier limited liability company of Subsidiary2, there is no plan or intention to liquidate Distributing1,

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Distributing², Controlled¹ and Controlled², to merge any such corporation with any other corporation, or to sell or otherwise dispose of any of the assets of any such corporation subsequent to the Spin-off except in the ordinary course of business.

- (j) The total adjusted basis and the fair market value of the assets transferred to Controlled¹ and Controlled² by Distributing¹ and Distributing², respectively, each equals or exceeds the sum of the liabilities assumed by Controlled¹ and Controlled² plus any liabilities to which the transferred assets are subject; and the liabilities assumed in the Spin-off 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.
- (k) Neither Distributing¹ nor Distributing² accumulated its receivables or made extraordinary payment of its payables in anticipation of the transaction.
- (l) No intercorporate debt will exist between Distributing¹ or Distributing² and Controlled¹ and Controlled², respectively, at the time of, or subsequent to, the Spin-off.
- (m) Immediately before the Spin-off, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (see Treasury Regulation sections 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; section 1.1502-13, as published by T.D. 8597). Neither Distributing¹ nor Distributing² will have an excess loss account in the Controlled¹ or the Controlled² stock, respectively, immediately before the Spin-off (see Treasury Regulation section 1.1502-19).
- (n) Payments made in connection with all continuing transactions, if any, between Distributing¹ and Distributing², on the one hand, and Controlled¹ and Controlled², on the other hand, will be for fair market value based on terms and conditions arrived at by parties bargaining at arms-length; however, certain payments may be at cost as dictated by constraints imposed by FederalAgencyA, FederalAgencyB, and other regulatory agencies.
- (o) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (p) For purposes of Code section 355(d), immediately after the completion of the transactions described in the Ruling Request, no person (determined after applying Code section 355(d)(7)) will hold stock possessing 50

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percent or more of the total combined voting power or total value of shares of all classes of the stock of any of Distributing1, Distributing2, Controlled1, or Controlled2 that was acquired by purchase (as defined in Code section 355(d)(5) and (8)) during the five-year period (determined after applying Code section 355(d)(6)) ending on the date of the completion of the transaction described in the Ruling Request.

- (q) The Spin-off 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% or more of the total combined voting power of all classes of stock of Distributing1, Distributing2, Controlled1, or Controlled2 entitled to vote, or stock possessing 50% or more of the total value of all classes of stock of Distributing1, Distributing2, Controlled1, or Controlled2.
- (r) There is currently no excess loss account in the stock of any of Distributing1, Distributing2, Controlled1 or Controlled2 and accordingly the proposed Spin-off will not result in the elimination of any excess loss account in the stock of any of Distributing1, Distributing2, Controlled1 or Controlled2.

RULINGS

Based solely on the information submitted and on the representations made, it is held as follows:

- (1) The respective transfers by the Distributing Corporations to the Controlled Corporations of assets solely in exchange for all of the stock of the Controlled Corporations, as described above, followed by the distributions of all of the stock of the Controlled Corporations to CommonParent ("the distributions") will be a reorganization within the meaning of §368(a)(1)(D). The Distributing Corporations and the Controlled Corporations will each be "a party to a reorganization" within the meaning of §368(b).
- (2) No gain or loss will be recognized by the Distributing Corporations upon the respective transfers of assets to the Controlled Corporations in exchange for stock of the Controlled Corporations, as described above. §361(a) and §357(a).
- (3) No gain or loss will be recognized by the Controlled Corporations on the respective receipt of the assets in exchange for stock in the Controlled Corporations, as described above. §1032(a).
- (4) The basis of the Distributing Corporations' assets received by the Controlled Corporations, respectively, will be the same as the basis of such assets in the hands of the Distributing Corporations, respectively, immediately prior to the Spin-off described above. §362(b).

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(5) The holding period of the Distributing Corporations' assets received by the Controlled Corporations, respectively, will include the period during which such assets were held by the Distributing Corporations, respectively. §1223(2).

(6) No gain or loss will be recognized by the Distributing Corporations upon the distributions of their stock in the Controlled Corporations to CommonParent, pursuant to the plan of reorganization, as described above. §361(c).

(7) No gain or loss will be recognized by (and no amount will be included in the income of) CommonParent upon the receipt of the stock of the Controlled Corporations in the distributions by the Distributing Corporations, as described above. §355(a)(1).

(8) The basis of the Distributing₁ stock and the Controlled₁ stock in the hands of the shareholders of Distributing₁ after the Spin-Off will, collectively, be the same as the aggregate basis of the Distributing₁ stock held immediately before the Spin-Off, and such basis will be allocated between the Distributing₁ stock and Controlled₁ stock in proportion to their relative fair market values at the time of the Spin-Off in accordance with Treas. Reg. §1.358-2(a)(2). The basis of the Distributing₂ stock and the Controlled₂ stock in the hands of the shareholders of Distributing₂ after the Spin-Off will, collectively, be the same as the aggregate basis of the Distributing₂ stock held immediately before the Spin-Off, and such basis will be allocated between the Distributing₂ stock and Controlled₂ stock in proportion to their relative fair market values at the time of the Spin-Off in accordance with Treas. Reg. §1.358-2(a)(2).

(9) The holding period of the stock of the Controlled Corporations (including any fractional share of the stock of the Controlled Corporations) received by CommonParent in the distributions will include the holding period of the stock of the respective Distributing Corporations on which the distributions are made, provided the stock of the Distributing Corporations is held as a capital asset on the date of the distributions. §1223(1).

(10) Earnings and profits will be allocated between the Distributing Corporations and the Controlled Corporations, respectively, in accordance with §312(h) and Treas. Reg. §§ 1.312-10 and 1.1502-33(f)(2).

No opinion is expressed as to the tax treatment of the transactions under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent by facsimile and mail to the taxpayer's representative.

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

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

Sincerely,
Steven J. Hankin
Senior Technical Reviewer, Branch 6
Office of Associate Chief Counsel
(Corporate)

cc: