

## Internal Revenue Service

## Department of the Treasury

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December 3, 2001

### Legend

Holdco =

Distributing =

Corp. 1 =

Corp. 2 =

Corp. 3 =

Corp. 4 =

Corp. 5 =

Certain Legal Regulation =

Business A =

Business B =

Business C =

Business D =

x =

We respond to your letter dated June 28, 2001, for rulings concerning the Federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated October 3 and November 15, 2001. The information submitted is summarized below.

Distributing is a domestic corporation that is not publicly traded, is closely-held, and is the common parent of a group of corporations filing a consolidated return. Distributing is a calendar-year, accrual basis taxpayer. Distributing is a regulated corporation,

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required to comply with Certain Legal Regulation for its entire operating group. Distributing has two classes of stock outstanding, voting common stock and nonvoting common stock.

Distributing owns virtually all of the outstanding stock in Corp. 1, which amount of stock satisfies the definition of control found in § 368(c). Corp. 1 is an accrual-method taxpayer. Distributing owns all the outstanding stock in Corp. 2 and Corp. 3. Corp. 2 owns all the outstanding stock in Corp. 4 and Corp. 5. Distributing and Corp. 2 are both holding companies.

Corp. 1 is engaged in Business A, Corp. 2's subsidiaries Corp. 4 and Corp. 5 are engaged in Businesses B and C, respectively, and Corp. 3 is engaged in Business D.

We have received financial information indicating that Businesses A, B, C, and D each have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Distributing desires to expand Business A by purchasing or creating one or more corporations like Corp. 1 to engage in Business A in another part of Corp. 1's state of operation. A body of regulation other than Certain Legal Regulation restricts, for the next several years, the ability of Corp. 1 itself to expand Business A into such other part of the state. Also, for business reasons Distributing finds so expanding Business A by creating or purchasing one or more corporations like Corp. 1 preferable to having Corp. 1 itself expand Business A. Certain Legal Regulation, however, requires that, for Distributing to expand Business A by creating or purchasing one or more corporations like Corp. 1, Distributing and its subsidiaries must cease operating Businesses B, C, and D.

To satisfy the requirement that its group cease operating Businesses B, C, and D, Distributing proposes taking the following steps:

Step 1. Distributing will incorporate Holdco. Holdco will be an accrual-method taxpayer.

Step 2. Distributing will contribute its stock in Corp. 1 to Holdco in a transaction intended to qualify as a tax-free reorganization under § 368(a)(1)(D) of the Internal Revenue Code (the "Contribution"). In connection with the transfer of Corp. 1 stock, Holdco will assume an existing liability of Distributing in the amount of approximately x. The issued and outstanding stock of Holdco will be identical to the issued and outstanding classes of stock of Distributing.

Step 3. Distributing will distribute all of the outstanding stock of Holdco pro-rata to the shareholders of Distributing (the "Distribution"). Each Distributing shareholder will receive one share of Class A voting common stock of Holdco relative to each share of Class A voting common stock of Distributing and one share of Class B nonvoting common stock relative to each share of Class B nonvoting common stock of Distributing. Immediately following the completion of the proposed transaction, all of the outstanding stock of Holdco will be directly owned by the shareholders of Distributing. The ownership will be pro-rata with no change to the proportionate voting percentages.

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The taxpayer has provided information demonstrating that the expansion of Business A is expected to increase the Distributing group's net income significantly.

The taxpayer has made the following representations in connection with the proposed transaction:

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

(b) The five years of financial information submitted on behalf of Distributing and its direct and indirect subsidiaries 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.

(c) The fair market value of the gross assets of Corp. 1's active business presently constitutes and will constitute at the time of the Distribution at least five percent of the total fair market value of all the gross assets of Corp. 1. In addition, the fair market value of the gross assets of each of Corp. 3's, Corp. 4's, and Corp. 5's active business presently constitutes and will constitute at least five percent of the total fair market value of all the gross assets of each company, respectively.

(d) Immediately after the distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock of Corp. 2 and Corp. 3; Corp. 3 is a controlled corporation that is engaged in the active conduct of a trade or business as defined in § 355(b)(2). Immediately after the distribution, at least 90 percent of the fair market value of the gross assets of Corp. 2 will consist of the stock of Corp. 4 and Corp. 5, controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2). Immediately after the distribution, at least 90 percent of the fair market value of the gross assets of Holdco will consist of the stock of Corp. 1, a controlled corporation that is engaged in the active conduct of a trade or business as defined in § 355(b)(2).

(e) Following the transaction, Corp. 1, Corp. 3, Corp. 4, and Corp. 5 will each continue the active conduct of its business, independently and with its separate employees.

(f) The distribution of the stock of Holdco is being carried out for the following corporate business purpose: The primary business purpose for the Distribution is to comply with divestiture requirements that will be imposed by the regulator as a condition for the approval of Distributing's plan to expand Business A into markets outside of the current city of operation. Distributing currently enjoys an exemption that allows it and its subsidiaries to engage in a number of activities that are ordinarily impermissible. The regulator has indicated in a letter from its general counsel that the expansion of Business A through the acquisition or establishment of one or more additional corporations would result in a loss of the exemption, necessitating the divestiture of the impermissible activities. The distribution of the stock of Holdco is motivated, in whole or in substantial part, by this corporate business purpose.

(g) There is no plan or intention by the shareholders or security holders of Distributing

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to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, Distributing or Holdco after the transaction.

(h) There is no plan or intention by Distributing or Holdco, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction.

(i) There is no plan or intention to liquidate Distributing or Holdco, to merge any corporation with any other corporation, or to sell or otherwise dispose of the assets of any corporation after the transaction, except in the ordinary course of business.

(j) No intercorporate debt, other than tax sharing payments, will exist between Distributing (or any of Distributing's affiliates) and Holdco (or any of Holdco's affiliates), at the time of, or subsequent to, the distribution of the stock of Holdco. These tax sharing payments will be paid in the ordinary course of business.

(k) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Furthermore, Distributing will not have an excess loss account with respect to the Holdco stock and no excess loss account will exist with respect to the stock of subsidiary members owned directly or indirectly by Holdco.

(l) Payments made in connection with all continuing transactions, if any, between Distributing (or any of Distributing's affiliates) and Holdco (or any of Holdco's affiliates) will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length. Currently, Corp. 1 leases space from Corp. 3 at arm's length.

(m) The Distribution is not part of a plan or series of related transactions 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 Distributing or Holdco, or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Holdco, within the meaning of § 355(e).

(n) No investment tax credit has been (or will be) claimed with respect to any assets transferred from Distributing to Holdco.

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

(p) The adjusted basis and the fair market value of the Corp. 1 stock equals or exceeds the sum of the liabilities assumed by Holdco (as determined under § 357(d)). The liabilities assumed in the transaction (as determined under § 357(d)) were incurred in the ordinary course of business and are associated with the Corp. 1 stock.

Based solely on the information submitted and the representations as set forth above, we hold as follows:

1. The transfer by Distributing of the Corp. 1 stock to Holdco solely in exchange for Holdco stock and the assumption of a liability, followed by the distribution of all the Holdco stock to Distributing's shareholders, will qualify as a reorganization within the

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meaning of § 368(a)(1)(D). Distributing and Holdco will each be a "party to a reorganization" within the meaning of § 368(b).

2. No gain or loss will be recognized by Distributing upon the transfer of the Corp. 1 stock to Holdco solely in exchange for Holdco stock and the assumption by Holdco of certain liabilities of Distributing. Sections 361(a) and 357(a).

3. No gain or loss will be recognized by Holdco on the receipt of the Corp. 1 stock in exchange for Holdco stock. Section 1032(a).

4. The basis of the Corp. 1 stock to be received by Holdco will be equal to the basis of such stock in the hands of Distributing immediately before the transfer. Section 362(b).

5. The holding period of the Corp. 1 stock in the hands of Holdco will include the period during which such stock was held by Distributing. Section 1223(2).

6. No gain or loss will be recognized by Distributing upon the distribution of all the stock of Holdco to the shareholders. Section 361(c)(1).

7. No gain or loss will be recognized to and no amount will be included in the income of the shareholders upon the receipt of all of the stock of Holdco from Distributing. Section 355(a)(1).

8. The aggregate basis of the common stock of Holdco and Distributing in the hands of shareholders after the Distribution will be the same as the basis of the Distributing common stock held immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with §§ 1.358-2(a)(2) and (a)(4). Section 358(a), (b), and (c).

9. The holding period of the Holdco stock received by the shareholders will include the holding period of the Distributing stock with respect to which the Distribution will be made, provided that the Distributing stock is held as a capital asset on the date of the Distribution. Section 1223(1).

10. Proper allocation of earnings and profits among Distributing and Holdco will be made under §§ 1.312-10(a) and 1.1502-33(e).

Except as specifically set forth above, no opinion is expressed concerning the Federal tax consequences of the proposed transaction under any other provision of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction.

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 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(k)(3) provides that it 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.

Sincerely yours,

Ken Cohen  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel (Corporate)

cc: