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Department of the Treasury

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February 16, 2000

Distributing =

Controlled =

Business A =

Large Business A Assets =

Small Business A Assets =

Non-Business A Assets =

Legal Advisors =

Financial Advisors =

L =

M =

N =

X =

This letter responds to your July 6, 1999 request for rulings on certain federal income tax consequences of a proposed transaction on behalf of the above-captioned taxpayer. Additional information was received on November 12, 1999, December 3, 1999, February 11, 2000 and February 16, 2000.

Distributing is the common parent of an affiliated group of corporations that files a consolidated federal tax return. The information submitted indicates that Distributing is a State X corporation engaged in Business A. Distributing's capital structure includes common stock and voting preferred stock. Distributing has L common stock holders and M preferred stock holders. There are N Distributing stock holders who hold both classes. Distributing includes Large Business A, Small Business A and Non-Business

PLR-112051-99

A assets. The federal government recently deregulated Business A. The deregulation allows for greater efficiencies through market, regional, and national consolidation. Given the competitive environment in Business A, Distributing's management decided that Distributing's business needed further expansion and therefore, additional capital. Distributing's management determined that the most cost efficient method of raising the additional capital was through an initial public offering ("IPO"). In 1998, Distributing undertook extensive efforts to go public, but the offering was aborted. Distributing's management, Legal Advisors and Financial Advisors determined that because Distributing: (i) contains Large Business A, Small Business A and Non-Business A assets; and (ii) has a complex capital structure containing both common and preferred stock, the public financial markets would significantly discount the offering price. Documents supporting the decision to terminate the offering have been received.

Consequently, to facilitate the IPO, Distributing proposes the following transactions:

- (i) Distributing will form Controlled (with a capital structure that mirrors Distributing's capital structure).
- (ii) Distributing will transfer to Controlled its Small Business A Assets and Non-Business A Assets in exchange for all of the common and preferred stock of Controlled and the assumption by Controlled of the liabilities related to the property transferred.
- (iii) Distributing will distribute all the common stock of Controlled to Distributing's common shareholders pro rata based upon the shares of common stock in Distributing held by each common shareholder immediately before the Distribution and will distribute all the Controlled preferred stock to Distributing's preferred shareholders in exchange for all of their Distributing preferred stock. The Distributing preferred stock will subsequently be canceled.

Financial information has been received that reflects that Distributing has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

In connection with the proposed transaction, the following additional representations are made:

- (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 is representative of the corporation's present operation, and with regard to such

PLR-112051-99

corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(c) Following the transaction, the Distributing and Controlled corporations will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by the distributing corporation prior to the consummation of the transaction.

(d) Immediately after the Distribution, at least five percent of the assets will be active trade or business assets as defined in § 355(b)(2).

(e) The Distribution is being carried out for the following corporate business purpose: To enable Distributing to engage in an IPO for the purpose of raising funds and to obtain publicly traded stock to expand its business. The distribution is motivated, in whole or substantial part, by this corporate business purpose.

(f) Except for the normal annual gifting of shares to children of shareholders for inheritance purposes, there is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled.

(g) 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 the transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

(h) Except as provided in this ruling request, 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 the assets of either corporation after the Distribution, except in the ordinary course of business.

(i) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled; and the liabilities assumed in the transaction 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.

(j) The income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of property.

(k) Distributing neither accumulated its receivables nor made extraordinary

PLR-112051-99

payments of its payables in anticipation of the Contribution and Distribution.

(l) 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.

(m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.

(n) Payments made in connection with all continuing transactions, if any, 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.

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

(p) The distribution 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.

(q) Less than 50 percent of the total combined voting power of all classes of Distributing stock entitled to vote and less than 50 percent of the total value of shares of all classes of Distributing stock will have been acquired by purchase under § 355(d)(5) or (8) during the five-year period ending on the date of the Distribution (determined after applying § 355(d)(6)).

(r) The Controlled preferred stock received by Distributing preferred stockholders is substantially identical (as defined in Prop. Treas. Reg. § 1.356-7(b)(2), 65 Fed. Reg. 4203 (2000)) to the Distributing preferred stock surrendered in exchange therefor.

(s) The IPO will be completed within 12-months of the issuance of this letter.

The representations provided by the taxpayer form a material basis for the issuance of this ruling. Based solely on the information submitted and the representations set forth above, we rule as follows:

(1) The transfer by Distributing to Controlled of its Small Business A assets and Non-Business A assets in exchange for all of the stock of Controlled and the assumption by Controlled of liabilities of Distributing, followed by the distribution of all of the common stock of Controlled to Distributing's common shareholders

PLR-112051-99

and the distribution of all of the preferred stock of Controlled to Distributing's preferred shareholders in exchange for all of the Distributing preferred stock owned by Distributing's preferred shareholders will constitute a reorganization under § 368(a)(1)(D) of the Code. Distributing and Controlled will each be "a party to a reorganization" under § 368(b) of the Code.

(2) Distributing will recognize no gain or loss upon the transfer of certain assets to Controlled in exchange for all of Controlled's stock and the assumption of certain Distributing liabilities by Controlled (Code §§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled on receipt of the Distributing assets in exchange for all the shares of Controlled (§ 1032(a)).

(4) Controlled's basis in the Distributing assets received will be the same as the basis of such assets in the hands of Distributing immediately before the transfer (§ 362(b)).

(5) Controlled's holding period for the assets received will include the period during which Distributing held the assets (§1223(2)).

(6) Distributing will recognize no gain or loss upon the distribution of all of its Controlled stock to Distributing shareholders, as described above, pursuant to § 311(a).

(7) Distributing shareholders will recognize no gain or loss (and no amount will be included in the income of) upon receipt of the Controlled stock in the distribution (§ 355(a)(1)).

(8) No gain or loss will be recognized to (and no amount will be included in the income of) Distributing's preferred stock holders upon receipt of preferred stock in Controlled in exchange for an equivalent percentage of preferred stock in Distributing, as described above (§ 355(a)(1)).

(9) The aggregate basis of the Controlled and the Distributing common stock in the hands of the Distributing common shareholders immediately after the Distribution will equal the aggregate basis of the Distributing common stock held by such shareholders immediately prior to the Distribution, allocated in proportion to the fair market value of each in accordance with § 358(b) and (c) and the regulations promulgated thereunder. In addition, the basis of the Controlled preferred stock in the hands of the Distributing preferred shareholders immediately after the Distribution of the Controlled stock will equal the basis of the Distributing preferred stock held by such shareholders immediately prior to the distribution (§ 358(a)(1)).

PLR-112051-99

(10) The Distributing shareholders' holding period in the Controlled stock received in the distribution will include the holding period of the Distributing stock held by such shareholders, provided that such stock is held as a capital asset by those respective shareholders on the day of the distribution (§ 1223(1)).

(11) As provided in § 312(h), a proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) and 1.1502-33(e)(3).

No opinion is expressed regarding the tax treatment of the transaction under any other section of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered in the above rulings.

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.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,
Assistant Chief Counsel (Corporate)
By: Lewis K Brickates
Assistant to Chief, Branch 2