

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

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Distributing =

Controlled =

P ' =

S =

Business X =

Business Y =

A =

B =

C =

D =

E =

G =

a =

b =

c =

d =

e =

f =

Dear

This letter responds to your December 22, 2000 request for rulings regarding the federal income tax consequences of a proposed transaction. The following information is contained in your letter and subsequent correspondence.

Distributing is a corporation engaged in Business X. Controlled is a corporation conducting Business Y that is wholly owned by Distributing. Distributing and Controlled are presently members of a consolidated group in which P is the common parent. P owns all the stock of corporation S, which in turn owns all the stock of Distributing. A, B, and C each own a percent of P. D owns b percent of P, and Controlled owns c percent of P. A, B, and C are siblings who are unrelated to D.

The taxpayers have submitted financial information indicating that Distributing and Controlled have gross income and operating expenses representing the active conduct of a trade or business during each of the past five years.

E is a key employee of Distributing. E wishes to acquire a significant equity interest in a corporation that reflects the value solely of Distributing's business. Distributing has provided information showing that transferring Distributing's business to an entity that would be owned by Distributing and E would be impractical. The parties also wish to simplify the corporate structure by eliminating P and S. Accordingly, the following transactions are proposed:

(i) P and S will each merge simultaneously into Distributing, solely in exchange for Distributing common stock, and simultaneously Controlled will transfer all its P stock to Distributing. After this step, A, B, and C each will own d percent of Distributing and D will own e percent of Distributing.

(ii) Controlled will issue additional shares of Controlled common stock to Distributing (the "Issuance") so that the Spin-Off of Controlled in step (iii) may occur on a share-for-share basis to the Distributing shareholders.

(iii) Distributing will distribute all its stock in Controlled pro rata to A, B, C, and D (the "Spin-Off").

(iv) E will purchase stock from Distributing which will constitute f percent of Distributing's outstanding stock. The purchase will be for cash equal to the fair market value of the purchased stock.

(v) Distributing will issue options to E to buy a number of shares equal to the number issued to E in step (iv). Such options will vest within one year of the Spin-Off.

After the Spin-Off, G will remain employed by Distributing and Controlled in his

current capacity. In addition, Distributing will provide certain administrative services to Controlled for one year following the Spin-Off.

Representations

The taxpayers make the following representations:

(a) To the best of Distributing's knowledge and belief, the mergers in step (i) will qualify as reorganizations under § 368(a)(1)(A).

(b) No part of the consideration distributed by Distributing will be received by A, B, C, or D as a creditor, employee, or in any capacity other than as a shareholder of Distributing.

(c) The five years of financial information submitted on behalf of Distributing and Controlled represents each corporation's present operations, and with regard to each such corporation, there have been no substantial operational changes since the date of the last financial statement submitted.

(d) Except as noted above, following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.

(e) The Spin-Off is motivated, in whole or substantial part, by the corporate business purpose of allowing E to purchase a significant equity interest in Distributing's business.

(f) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any Distributing or Controlled stock after the transaction.

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

(h) There is no plan or intention to liquidate 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 transaction, except in the ordinary course of business.

(i) Payments made in connection with any 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.

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

(k) 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 §§ 1.1502-13 and 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147 and, as currently in effect, § 1.502-13 as published by T.D. 8597.) Further, Distributing's excess loss account, if any, with respect to the Controlled stock will be included in income immediately before the Spin-Off (See § 1.1502-19).

(l) The Spin-off 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 combined voting power of all classes of stock of Distributing or Controlled entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing or Controlled stock, within the meaning of § 355(e).

Rulings

(1) Controlled will recognize gain, if any, under section 311(b) on the transfer of its P stock to Distributing in step (i) above.

(2) The Issuance described in step (ii) above will not result in taxable income to Distributing (§ 305(a)).

(3) No gain or loss will be recognized by Distributing on the Spin-Off (§ 355(c)).

(4) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) A, B, C, or D on their receipt of Controlled stock in the Spin-Off (§ 355(a)(1)).

(5) The aggregate basis of the Controlled and Distributing stock in the hands of each of A, B, C, and D after the Spin-Off will equal such shareholder's basis in the Distributing stock held immediately before the Spin-Off (§ 358(a)(1)), allocated between the Controlled and Distributing stock in proportion to fair market value in accordance with § 1.358-2(a)(2) of the Income Tax Regulations (§ 358(b)(2) and (c)).

(6) The holding period of the Controlled stock received by A, B, C, and D will include the holding period of the Distributing stock on which the Spin-Off is made, provided the stock is held by the shareholder as a capital asset on the date of the Spin-Off (§ 1223(1)).

(7) The earnings and profits of Distributing and Controlled shall be adjusted as required by section 312(h) and sections 1.312-10(b) and 1.1502-33 of the Income Tax Regulations.

Caveats

We express no opinion on the federal income tax treatment of the proposed transaction under other provisions of the Code or regulations (including the consolidated return regulations) or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically covered by the above rulings.

Procedural Statements

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.

Each taxpayer involved in the transaction should attach a copy of this letter to the taxpayer's federal income tax return for the taxable year in which the transaction is 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,
Associate Chief Counsel (Corporate)
By: Stephen P. Fattman
Acting Counsel to the Associate
Chief Counsel (Corporate)