

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

July 3, 2001

Legend

Distributing =

Intermediate =

Controlled =

Subsidiary =

Family Group A =

Family Group B =

Business A =

State X =

State Y =

Amount Z =

Reason M =

This responds to your letter dated January 22, 2001, requesting rulings in connection with a proposed corporate separation pursuant to § 355 of the Internal Revenue Code. These rulings were requested for Distributing, Intermediate, and Controlled. Additional information was received in letters dated April 9, 2001, and June 19, 2001. The material information submitted is summarized below.

Distributing is a State X corporation and is the parent of an affiliated group of corporations consisting of Distributing, Intermediate, Controlled, and Subsidiary. The affiliated group files its federal income tax returns on a consolidated basis. Family Group A and Family Group B own a significant portion of Distributing stock. The remainder of the stock is held by less than five percent shareholders.

Distributing is a first-tier holding company that has owned 100% of the stock of Intermediate continuously for over five years. Intermediate has only common stock outstanding. Intermediate is a second-tier holding company, incorporated in State Y, that has owned 100% of the stock of both Controlled and Subsidiary continuously for over five years. Both Controlled and Subsidiary have only common stock outstanding. Both Controlled and Subsidiary are State X corporations that have been directly engaged in Business A for over five years. Distributing and Intermediate are both indirectly engaged in Business A through their direct and indirect ownership of Controlled and Subsidiary.

Subsidiary conducts Business A primarily in urban and suburban locations. Controlled conducts Business A primarily in rural locations. Subsidiary's business is expected to grow significantly faster than Controlled's business. Distributing's management plans a stock offering in the approximate amount of Amount Z to meet the requirements of this faster growth, to meet Reason M, and to reduce outstanding debt. Members of Family Group A and Family Group B will not acquire additional stock in the offering.

Taxpayer has presented data indicating that this planned stock offering would attract significantly more funds per share if Controlled were separated from Subsidiary.

To accomplish the separation of Subsidiary from Controlled, Distributing proposes the following transaction ("Split-off"):

- (A) Intermediate will distribute all the shares of Controlled common stock to Distributing ("First Distribution").
- (B) Distributing will distribute all the shares of Controlled common stock to electing shareholders in exchange for shares of Distributing common stock ("Second Distribution").

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- (C) Distributing will make an offering of its common stock within one year of the above distributions.

The following representations have been made in connection with the above distributions:

- (1) No part of the consideration to be distributed by Distributing in the Split-off is being received by an electing shareholder as a creditor, employee or in any capacity other than that of a shareholder of Distributing.
- (2) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operations, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.
- (3) The five years of financial information submitted on behalf of Intermediate is representative of Intermediate's present operations, and with regard to Intermediate, there have been no substantial operational changes since the date of the last financial statements submitted.
- (4) The five years of financial information submitted on behalf of Subsidiary is representative of Subsidiary's present operations, and with regard to Subsidiary, there have been no substantial operational changes since the date of the last financial statements submitted.
- (5) The five years of financial information provided on behalf of Controlled is representative of Controlled's present operations, and with regard to Controlled, there have been no substantial operational changes since the date of the last financial statements submitted.
- (6) Following the Split-off, Distributing, Intermediate, and Subsidiary on the one hand, and Controlled on the other hand, will each continue the active conduct of their respective trades or businesses, independently and with their separate employees.
- (7) Distributing, Intermediate, Controlled and their respective shareholders will each pay their own expenses, if any, incurred in connection with the Split-off.
- (8) The distribution of Controlled common stock by Distributing will be non-pro rata with respect to holders of Distributing common stock. The electing shareholders will surrender only their Distributing common stock in the Split-off and will not receive any consideration other than Controlled

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common stock in exchange for the Distributing common stock surrendered therefor pursuant to the Split-off.

- (9) The fair market value of the Controlled common stock received by each electing shareholder will be approximately equal to the fair market value of the Distributing common stock surrendered by the electing shareholder in the exchange.
- (10) The distributions of Controlled common stock are carried out for the corporate business purposes of: (a) facilitating a stock offering of Distributing common stock; (b) facilitating the issuance of stock options to key employees of Subsidiary; and (c) resolving Controlled's competitive disadvantage because Controlled is controlled by a holding company that is not located in Controlled's rural community. The distributions of Controlled common stock are motivated, in whole or substantial part, by this corporate business purpose.
- (11) Immediately after the distributions, at least 90 percent of the fair market value of the gross assets of Intermediate will consist of stock of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (12) Immediately after the distributions, at least 90 percent of the fair market value of the gross assets of Distributing will consist of stock of corporations at least 90 percent of the fair market value of whose gross assets will consist of stock of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (13) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing or Controlled to make an S corporation election pursuant to § 1362(a).
- (14) 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 after the Split-off.
- (15) 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 § 4.05(1)(b) of Rev. Proc. 96-30.
- (16) There is no plan or intention to liquidate Distributing, Intermediate, Subsidiary or Controlled, to merge Distributing, Intermediate, Subsidiary

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or Controlled with any other corporation, or to sell or otherwise dispose of the assets of Distributing, Intermediate, Subsidiary or Controlled after the Split-off, except in the ordinary course of business.

- (17) The distributions are 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% or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50% or more of the total value of shares of all classes of either Distributing or Controlled.
- (18) Neither Distributing nor any of its subsidiaries have accumulated their receivables or made extraordinary payment of their payables in anticipation of the transaction.
- (19) No income items, including accounts receivable or any items resulting from a sale, exchange or disposition of property, that would have resulted in income to Distributing and no items of expense will be transferred to Controlled, if Distributing has earned the right to receive the income or could claim a deduction for the expense under the accrual or similar method of accounting.
- (20) Except for deposits in the ordinary course of business, no intercorporate debt will exist between Distributing and Controlled or between Intermediate and Controlled at the time of, or subsequent to, the distributions.
- (21) Immediately before the distributions, items of income, gain, loss, deduction and credit will be taken into account as required by the applicable intercompany transaction regulations under Treasury Regulation §§ 1.1502-13 and 1.1502-14 as in effect at the time of the distributions. Further, Distributing and Intermediate will not have an excess loss account with respect to the stock of Controlled.
- (22) Payments made in connection with all continuing transactions, if any, between Distributing or its subsidiaries and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (23) No two parties to the transactions are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (24) For purposes of § 355(d), immediately after the First Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing

50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Intermediate stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the First Distribution.

- (25) For purposes of § 355(d), immediately after the First Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Controlled stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the First Distribution.
- (26) For purposes of § 355(d), immediately after the Second Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the Second Distribution.
- (27) For purposes of § 355(d), immediately after the Second Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Controlled stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the Second Distribution.
- (28) To the best knowledge of Distributing and the representatives of Distributing, there is no plan or intention by the continuing shareholders to sell or exchange any of their stock in Distributing subsequent to the distribution date and there is no plan or intention by the continuing shareholders to sell, exchange, transfer by gift or otherwise dispose of a number of shares of Distributing common stock that would reduce their ownership of Distributing common stock to a number of shares having a value, immediately after the Split-off, of less than 50% of the value of all formerly outstanding shares of Distributing common stock as of such time.
- (29) To the best knowledge of Distributing and the representatives of Distributing, there is no plan or intention by the electing shareholders to sell or exchange any of their stock in Controlled subsequent to the distribution date and there is no plan or intention by the electing

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shareholders to sell, exchange, transfer by gift or otherwise dispose of a number of shares of Controlled common stock that would reduce their ownership of Controlled common stock to a number of shares having a value, immediately after the Split-off, of less than 50% of the value of all formerly outstanding shares of Controlled common stock as of the same date.

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

- (a) Intermediate will recognize no gain or loss upon the distribution of the Controlled common stock to Distributing in the First Distribution. § 355(c).
- (b) Distributing will recognize no gain or loss (and no amount will be included in the income of Distributing) upon the receipt of the Controlled common stock from Intermediate in the First Distribution.
§ 355(a)(1); Rev. Rul. 62-138, 1962-2 C.B. 95.
- (c) The aggregate basis of the Intermediate common stock and the Controlled common stock in the hands of Distributing after the First Distribution will equal the basis of the Intermediate common stock held by Distributing immediately before the First Distribution, allocated in proportion to their relative fair market values in accordance with Treasury Regulation § 1.358-2(a)(2). §§ 358(b) and 358(c).
- (d) The holding period of the Controlled common stock received by Distributing will include Distributing's holding period of the Intermediate common stock on which the distribution of the Controlled common stock by Intermediate will be made, provided that such Intermediate common stock is held as a capital asset on the date of the First Distribution.
§ 1223(1); Treasury Regulation § 1.1223-1(a).
- (e) The current and accumulated earnings and profits of Intermediate shall be adjusted as required under § 312(h) and Treasury Regulation §§ 1.312-10(b) and 1.1502-33.
- (f) Distributing will recognize no gain or loss on the distribution of Controlled Common Stock to the electing shareholders in the Second Distribution.
§ 355(c).
- (g) The electing shareholders of Distributing will recognize no gain or loss (and no amount will be included in the income of any electing shareholder of Distributing) on the receipt of Controlled common stock from

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Distributing in exchange for their shares of Distributing common stock in the Second Distribution. § 355(a)(1).

- (h) The aggregate basis, immediately after the Second Distribution, of the Controlled common stock and the Distributing common stock in the hands of an electing shareholder that does not exchange all of its Distributing common stock for shares of Controlled common stock will be the same as the aggregate basis of the Distributing common stock held by such electing shareholder immediately prior to the distribution, allocated between the Distributing common stock and the Controlled common stock in proportion to the fair market value of each, in accordance with § 358(b), Treasury Regulation § 1.358-1(a) and Treasury Regulation § 1.358-2(a)(2).
- (i) The basis of the Controlled stock in the hands of Distributing's shareholders that exchange all of their Distributing common stock for shares of Controlled common stock will be the same as the basis of the Distributing stock surrendered in exchange therefor. § 358(a)(1).
- (j) The holding period of Controlled common stock received by an electing shareholder of Distributing in the Second Distribution will include the holding period of the Distributing common stock on which the distribution of the Controlled common stock by Distributing will be made, provided that such Distributing common stock is held as a capital asset on the date of the Second Distribution. § 1223(1); Treasury Regulation § 1.1223-1(a).
- (k) The current and accumulated earnings and profits of Distributing shall be adjusted as required under § 312(h) and Treasury Regulation §§ 1.312-10(b) and 1.1502-33.

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.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

In accordance with the Power of Attorney on file with this office, a copy of this

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letter is being sent to the taxpayer.

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

Sincerely yours,
Associate Chief Counsel (Corporate)
By: Charles Whedbee
Senior Technician Reviewer
Branch 5