

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

July 11, 2001

In Re:

Distributing =

Controlled =

U.S. Sub =

F Sub 1 =

F Sub 2 =

Business A =

Business B =

Business C =

State X =

Country A =

Country B =

Date X =

We respond to your letter dated February 22, 2001, in which rulings are requested regarding the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated March 15th, April 18th, May 8th, May 21st, June 22<sup>nd</sup>, June 28<sup>th</sup>, June 29<sup>th</sup>, July 2<sup>nd</sup>, July 3<sup>rd</sup>, and July 9th of 2001. The information submitted is summarized below.

Distributing is a State X corporation engaged in Business A, Business B and Business C. Distributing has two classes of stock outstanding, voting common stock and preferred stock. Distributing's stock is publicly traded and widely held.

Controlled is a State X corporation formed on Date X as a wholly owned subsidiary of Distributing. Controlled has only one class of outstanding stock, voting common stock.

U.S. Sub is a State X corporation that is a wholly owned subsidiary of Distributing. U.S. Sub is engaged in Business B. Distributing also owns foreign subsidiaries engaged in Business B. In the United States, Business B is primarily operated by U.S. Sub. Internationally, Distributing owns all of the stock of F Sub 1, a Country A subsidiary and F Sub 2, a Country B subsidiary, that are each engaged in Business B.

Management of Distributing believes that separating Business A and Business B into independent corporations will allow each to focus its resources more successfully and enhance the success of each business by resolving systemic and other problems attributable to their common ownership and operation. The taxpayer has provided sufficient substantiation of the business purpose for the proposed separation of Business A and Business B.

Accordingly, Distributing will transfer U.S. Sub, F Sub 1, F Sub 2, and certain Business B assets and liabilities held by Distributing to Controlled. The liabilities will be assumed under a new assumable borrowing facility of Distributing to establish appropriate capital structure and liquidity for Distributing and Controlled. Thereafter, Distributing will distribute all of its shares of Controlled stock pro rata to its shareholders. Certain transition agreements will exist between Distributing and Controlled to effectuate the proposed spin off and to delineate relationships between the parties thereafter.

### **The Representations**

The taxpayer has made the following representations with respect to the proposed transaction:

- (a) At the time of the distribution, there will be no indebtedness between Distributing and Controlled, except for amounts owed in connection with transactions in the ordinary course of business or in connection with certain transition agreements, and any such indebtedness incurred will not constitute stock or securities.
- (b) 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 Distributing shareholder. Certain employees who now hold shares of restricted Distributing common stock may receive shares of restricted Controlled common stock in the distribution.
- (c) The 5 years of financial information submitted on behalf of Distributing's Business A operations, is representative of that corporation's present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) The 5 years of financial information submitted on behalf of U.S. Sub's business is representative of that corporation's present operation, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the transaction, Distributing and U.S. Sub will each continue the active conduct of its business, independently and with its separate employees. There will be no sharing of employees between Distributing and U.S. Sub after the distribution.
- (f) Immediately after the distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of the stock of U.S. Sub, a controlled corporation that is engaged in the active conduct of a trade or business as defined in § 355(b)(2) of the Internal Revenue Code.
- (g) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to allow each of Business A and Business B to focus its resources more successfully and enhance the success of each business by resolving systemic and other problems attributable to their common ownership and operation. The distribution of the stock, or stock and securities, of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (h) The management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any shareholder or security holder of Distributing to sell, exchange or transfer by gift, or otherwise dispose of

any stock in, or securities of, either Distributing or Controlled after the transaction, except (i) sales of fractional shares of Controlled common stock distributed in the distribution, and (ii) gifts and intra-family transfers by certain executives of Distributing and its affiliates. Distributing also expects that certain shareholders may sell Controlled common stock in the market in order to re-balance their portfolios or otherwise meet their investment criteria.

- (i) 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 Revenue Procedure 96-30 and stock purchases by Distributing or Controlled in connection with derivatives transactions entered into by Distributing or Controlled, respectively, in connection with their stock repurchase programs.
- (j) Except for Distributing's publicly announced intention to dispose of Business C, 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 transaction, except in the ordinary course of business.
- (k) Payments made in connection with all continuing transactions between Distributing and Controlled, if any, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (l) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (m) The distribution of Controlled stock 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.
- (n) 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. Further, Distributing will not have any excess loss account with respect to the Controlled common stock.
- (o) 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 (as determined under § 357(d)) by Controlled.

- (p) The liabilities assumed (as determined under § 357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred, or are part of the debt assumption described above.
- (q) Immediately after the distribution, the gross assets of U.S. Sub used in the active conduct of the Business B operations will have a fair market value equal to at least 5 percent of the total fair market value of the gross assets of U.S. Sub.
- (r) Neither F Sub 1 nor F Sub 2 will have any securities outstanding at the time of the proposed transactions.
- (t) Distributing has not been a “United States real property holding corporation” (“USRPHC”) at any time during the 5 year period ending on the date of the distribution. Neither Distributing nor Controlled will be a USRPHC immediately after the distribution.
- (u) Distributing does not have any 5 percent shareholders, and neither Distributing nor Controlled will have any 5 percent shareholders immediately after the distribution.
- (v) In connection with the proposed transactions, Distributing will make appropriate basis and earnings and profits adjustments as required by § 367(b) and § 1.367(b)-5 of the Income Tax Regulations.
- (w) No assets will be transferred by Distributing, Controlled, U.S. Sub, or any of their U.S. affiliates, to F Sub 1, F Sub 2, or any other foreign subsidiary of Controlled or U.S. Sub in connection with the proposed transactions.

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

- (1) The transfer by Distributing to Controlled of assets, in exchange for the stock of Controlled and the assumption of certain liabilities, followed by the distribution of all of the stock of Controlled to shareholders of Distributing will qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled 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

assets to Controlled solely in exchange for stock of Controlled and the assumption of liabilities (§§ 361(a) and 357(a)).

- (3) No gain or loss will be recognized by Controlled upon the receipt of assets in exchange for the stock of Controlled (§ 1032).
- (4) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of Controlled to its shareholders (§ 361(c)(1)).
- (5) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately before their transfer to Controlled (§ 362(b)).
- (6) The holding period of the assets transferred to Controlled will include the period during which such assets were held by Distributing (§ 1223(2)).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the shareholders of Distributing upon receipt of Controlled stock (§ 355(a)(1)).
- (8) The basis of the stock of Controlled and Distributing in the hands of the shareholders of Distributing after the distribution will be the same as the aggregate basis of the Distributing stock held immediately before the distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a) (§ 358(b)(2)).
- (9) The holding period of the Controlled stock received by a shareholder of Distributing will include the holding period of the Distributing stock with respect to which the distribution was made, provided the shareholder held such stock as a capital asset on the date of the transaction (§ 1223(1)).
- (10) As provided in § 312 (h), following distribution of the stock of Controlled, proper allocation of earnings and profits will be made between Distributing and Controlled in accordance with § 1.312-10(a).
- (11) Shareholders of Distributing who receive cash from the distribution agent in respect of fractional shares of Controlled common stock will recognize gain or loss on the sale of such fractional shares equal to the difference between the cash received and the holder's basis in that fractional share (§ 1001). Provided that the fractional share is a capital asset in the hands of the exchanging shareholder, such gain or loss will be capital gain or loss to such holder (§ 1221).

### **Caveats**

Except as specifically ruled above, no opinion is expressed concerning the federal income tax consequences of the proposed transaction. Specifically no opinion is expressed regarding whether any or all of the above-referenced foreign corporations are passive foreign investment companies (within the meaning of § 1297(a)). If it is determined that any or all of the above described foreign corporations are passive foreign investment companies, no opinion is expressed with respect to the application of §§ 1291 through 1298 to the proposed transaction. In particular, in a transaction in which gain is not otherwise recognized, regulations under § 1291(f) may require gain recognition notwithstanding any other provision of the Code.

No opinions have been requested and none are provided about the federal income tax consequences of taxpayer's proposed foreign restructuring transactions. In particular, no opinion is expressed about the application of § 367(b) (i.e. § 1.367(b)-5(c)) or § 1248 to the foreign restructuring transactions. In addition, we express no opinion about the tax treatment of the proposed transaction under other provisions 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 that are not specifically covered by the above rulings.

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.

### **Procedural Matters**

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to the taxpayer's authorized representative.

Sincerely yours,  
Associate Chief Counsel (Corporate)  
By: Debra Carlisle  
Branch Chief, Branch 5