

Internal Revenue Service

Department of the Treasury

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Date:

September 6, 2001

Distributing =

Controlled =

State X =

Business A =

Business B =

Line B -1 =

A =

B =

C =

D =

E =

F =

G =

Investment Banker =

n =

o =

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p =
q =
r =
s =
t =
u =
v =
w =
x =
y =
z =
aa =
bb =

This is in response to a letter dated February 21, 2001, in which rulings were requested as to the federal income tax consequences of a proposed transaction. Additional information was submitted on May 21, May 22, June 14, June 27, July 24, and July 25, 2001. The facts submitted for consideration are substantially as set forth below.

Distributing is a State X accrual basis corporation engaged in Business A and Business B. Distributing has outstanding n shares of common stock held by o shareholders. There are three shareholders who own greater than 5 percent of the stock of Distributing as follows:

<u>Shareholder</u>	<u>Shares</u>	<u>Percentage</u>
A	<u>p</u>	<u>s</u>
B	<u>q</u>	<u>t</u>
C	<u>r</u>	<u>u</u>

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Controlled is State X accrual basis corporation engaged in Business B. Controlled has outstanding y shares of common stock held as follows:

<u>Shareholder</u>	<u>Shares</u>
Distributing	<u>w</u>
D	<u>x</u>
E	<u>y</u>
F	<u>z</u>
G	<u>aa</u>

Financial information has been submitted indicating that each of Business A and Line B -1 has had gross receipts and operating expenses representation of the active conduct of a trade or business for each of the last 5 years.

In order to raise capital to be used to expand Business B, it is proposed that Controlled engage in private placements and, ultimately, an initial public offering. Controlled has been advised by Investment Banker, its financial adviser, that a spin-off wherein Controlled operates as a distinct entity from Distributing would result in significantly higher valuations per share than would otherwise be the case, for both private and public placements of capital.

Accordingly, the following transaction is proposed:

- (i) Distributing will transfer the assets and liabilities of Line B to Controlled (the "Contribution").
- (ii) Distributing will distribute all of its Controlled stock (representing in excess of 80 percent of the outstanding Controlled stock) to its shareholders on a pro rata basis.
- (iii) Controlled will sell newly issued shares of Controlled stock to investors in a private placement later this year.

In connection with the proposed transaction the taxpayer represents as follows:

- (a) The indebtedness owed by Controlled to Distributing after the distribution, if any, 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 shareholder of Distributing.
- (c) Except for indebtedness that may arise as a result of certain agreements

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between Distributing and Controlled, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution.

- (d) The 5 years of financial information submitted on behalf of each of Business A and Business B is representative of each business's present operations, and with regard to each business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (f) The distribution will be carried out for the following corporate business purpose: to facilitate stock offerings in Controlled. The distribution of the stock, or stock and securities, of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (g) 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 stock in, or securities of, either Distributing or Controlled after the distribution.
- (h) There is no plan or intention by Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the distribution.
- (i) 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.
- (j) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing in the Contribution each equals or exceeds the sum of the liabilities assumed (as determined under § 357(d)) by Controlled.
- (k) The liabilities assumed by Controlled (as determined under § 357(d)) in the Contribution, if any, were incurred in the ordinary course of business and are associated with the assets being transferred.
- (l) Immediately before the distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable

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intercompany transaction regulations (See § 1.1502-13 and § 1.1502-14 of the Income Tax Regulations as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597).

- (m) 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.
- (n) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (o) Distributing and Controlled and their respective shareholders will each pay their own expenses, if any, incurred in connection with the distribution.
- (p) Immediately after the distribution, no person will hold, directly or indirectly, disqualified stock (within the meaning of § 1.355-6(b)(2)) in Distributing or Controlled that constitutes a 50 percent or greater interest in Distributing or Controlled.
- (q) 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 a 50 percent or greater interest (as defined in § 355(e)(4)(A)) in either Distributing or Controlled.

Based on the information submitted and on the representations set forth above, it is held as followed:

- (1) For federal income tax purposes, the Contribution will be viewed as a transfer to Controlled in constructive exchange for an amount of Controlled stock equal in value to the net value of the assets transferred followed by a transfer by Distributing of bb percent of the stock constructively received to shareholders D, E, F, and G in amounts proportionate to their ownership in Controlled prior to the Contribution.
- (2) The Contribution, solely in exchange for a constructive issuance of Controlled stock followed by the distribution of Controlled stock to Distributing shareholders will qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be a "party to a reorganization" within the meaning of § 368(b).
- (3) No gain or loss will be recognized by Distributing upon the transfer of the property to Controlled in constructive exchange for Controlled stock and the assumption of liabilities pursuant to the Contribution (§§ 361(b) and

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357(a)).

- (4) No gain or loss will be recognized by Controlled upon the receipt of property in constructive exchange for Controlled stock (§ 1032(a)).
- (5) The basis of the assets transferred in the Contribution in the hands of Controlled will be the same as the basis of such assets in the hands of Distributing immediately before the Contribution (§ 362(b)).
- (6) The holding period of the assets transferred in the Contribution in the hands of Controlled will include the period during which such assets were held by Distributing (§ 1223(2)).
- (7) No gain or loss will be recognized by Distributing upon distribution of the Controlled stock in the distribution (§ 361(c)).
- (8) No gain or loss will be recognized by (and no amount will be included in the income of) a Distributing shareholder upon the receipt of the Controlled stock in the distribution (§ 355(a)).
- (9) The aggregate basis of a Distributing shareholder's Controlled and Distributing stock after the distribution will be same as such shareholder's aggregate basis in Distributing immediately before the distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a) (§ 358(b)(2)).
- (10) The holding period of the Controlled stock received in the distribution by a Distributing shareholder will include the holding period of the Distributing stock with respect to which the distribution will be made, provided that such Distributing stock is held as a capital assets on the date of the distribution (§ 1223(1)).
- (11) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 1.312-10(a).

No opinion is expressed as to the tax treatment of the transfer by Distributing of bb percent of the Controlled stock to Shareholders D, E, F, and G. Furthermore, we express no opinion about the tax treatment of the 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 transaction that are not specifically covered by the above rulings.

This letter is directed only to the taxpayer who requested 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 returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

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

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