

Internal Revenue Service

Department of the Treasury

Index Number: 0355.01-00
0368.04-00

Washington, DC 20224

Number: **199921027**
Release Date: 5/28/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP:4 PLR-117095 -98
Date:
February 25, 1999

Parent =

Corporation A =

Corporation B =

Corporation C =

Corporation D =

Distributing =

Controlled 1 =

Sub 1 =

PLR-117095-98

2

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

Sub 7 =

Sub 8 =

Controlled 2 =

Disregarded =

Newco =

Holdco =

Type X =

Type Y =

a =

b =

c =

d =

e =

f =

Business A =

Country A =

Country B =

Date X =

Date Y =

Date Z =

Dear

This letter responds to your August 31, 1998 request for rulings on certain federal income tax consequences of a transaction. The information submitted in that request and later correspondence is summarized below.

Summary of Facts

Publicly held Parent is the common parent of a consolidated group engaged in Business A. Parent wholly owns Corporation A and owns all of the Type X voting common stock of Corporation B. Corporation A owns a percent of the Type Y voting common stock of Corporation B. The remaining Type Y voting common stock of Corporation B is owned by five members of the Board of Directors of Corporation B in trust for the benefit of Corporation A. Corporation A wholly owns Corporation C and owns b shares (all but one) of Corporation D. The sole remaining share of Corporation D is owned by Corporation C. Corporation C wholly owns Distributing. Distributing wholly owns Controlled 1, Sub 1, Sub 2, Sub 3, and Sub 4. Distributing owns all but c shares of Sub 5, all but d shares of Sub 6, and all but c shares of Sub 7. The remaining shares of Sub 5, Sub 6, and Sub 7 are owned by Corporation C. Distributing owns e percent of Sub 8 and Controlled 1 owns the remaining shares of Sub 8. Parent, Corporation A, and Corporation C are domestic corporations and join in the filing of a consolidated federal income tax return. Sub 1, Sub 2, Sub 3, Sub 4, Sub 5, Sub 6, Sub 7, Sub 8 (the "Indicated Affiliates"), Distributing, Corporation B, Corporation D, and Controlled 1 are foreign corporations.

We have received financial information indicating that each of Distributing, the Indicated Affiliates, and Controlled 1 has had gross receipts and operating expenses in Business A representing the active conduct of a trade or business for each of the past five years.

Prior to the proposed transaction described below, Distributing will distribute cash to Corporation C to reduce the stated capital of its common shares and to redeem preferred shares for Country A purposes (the "Pre-Transaction Dividend"). Distributing represents that, to its best knowledge and belief, the Pre-Transaction Dividend will be treated as a dividend distribution under §§ 301(c)(1) and 302(d) of the Internal Revenue Code.

Proposed Transaction

To achieve significant cost savings, Parent has proposed the following transaction:

(i) Distributing incorporated Controlled 2, a Country B limited liability company, on Date X in anticipation of the transaction. Controlled 2 will be treated as a corporation for U.S. federal tax purposes. Distributing will transfer all of its shares of the Indicated Affiliates to Controlled 2 in exchange for additional common shares of Controlled 2 (the "First Contribution").

(ii) Distributing will recapitalize, issuing preferred and common shares to Corporation C in exchange for all of Corporation C's Distributing common shares. The preferred shares issued by Distributing will have an aggregate fair market value equal to the aggregate fair market value of the shares of the Indicated Affiliates transferred in the First Contribution and the shares of Controlled 1.

(iii) Corporation C incorporated Disregarded, a Country A unlimited liability company, on Date Y in anticipation of the transaction. Corporation C will contribute all of its Distributing preferred stock to Disregarded in exchange for common shares of Disregarded. Taxpayer represents that Disregarded will be disregarded as an entity separate from Corporation C for U.S. federal tax purposes.

(iv) Disregarded incorporated Newco, a wholly owned Country A limited liability company with an authorized share capital of common and preferred shares, on Date Y in anticipation of the transaction. Disregarded subscribed for Newco common shares for nominal consideration.

(v) Distributing will transfer all of its Controlled 1 common shares and Controlled 2 common shares to Newco in exchange for Newco preferred shares. The Newco preferred shares will be redeemable for an amount equal to the aggregate fair market

value of Controlled 1 and Controlled 2 at the time of the transfer plus any accrued but unpaid dividends on the Newco preferred shares (the "Redemption Amount").

(vi) Newco will redeem the Newco preferred shares held by Distributing at the Redemption Amount. The Redemption Amount will be satisfied by Newco's issuance of a demand, non-interest bearing promissory note to Distributing (the "Newco Note").

(vii) Newco will be voluntarily dissolved and liquidated, and its assets will be transferred to and its liabilities assumed by Disregarded. Specifically, Disregarded will acquire all of the common shares of both Controlled 1 and Controlled 2 and will assume the obligation under the Newco Note.

(viii) Distributing will purchase for cancellation the Distributing preferred shares held by Disregarded in exchange for a demand, non-interest bearing note for the Redemption Amount issued by Distributing to Disregarded (the "Distributing Note"). Distributing will cancel the preferred shares so purchased.

(ix) The Distributing Note and the Newco Note will be set off against each other and canceled.

(x) Parent will contribute all of its Corporation B shares to Corporation A (the "Second Contribution").

(xi) Corporation A will contribute all of its Corporation B and Corporation D shares to Corporation C (the "Third Contribution").

(xii) Corporation C formed Holdco, a domestic corporation, on Date Z in anticipation of the proposed transaction. Corporation C will contribute all of its interests in Corporation B, Corporation D, Sub 5, Sub 6, and Sub 7 to Holdco in exchange for Holdco voting common shares (the "Fourth Contribution").

(xiii) Disregarded will transfer all of the outstanding shares of both Controlled 1 and Controlled 2 to Holdco in exchange for Holdco voting preferred shares of equal value (the "Fifth Contribution").

(xiv) Holdco will establish a Country B branch and will allocate to that branch all of its outstanding shares of Controlled 2 for an interest-free intracompany advance with a principal amount equal to the fair market value of the Controlled 2 shares (which equals the aggregate value of the Indicated Affiliates, except for the value of the shares of Sub 8 owned by Controlled 1). Holdco's Country B branch will be a branch for U.S. tax law and Country B commercial and tax law purposes.

Representations

Parent requests rulings that the transfers and exchanges described above in steps (ii) through (ix) will be treated for federal income tax purposes as if Distributing had distributed the stock of Controlled 1 to Corporation C (the "First Distribution") and distributed the stock of Controlled 2 to Corporation C (the "Second Distribution").

First Distribution Representations

Parent has made the following representations concerning the First Distribution:

- (a) Controlled 1 will not be indebted to Distributing after the First Distribution.
- (b) No part of the consideration distributed by Distributing will be received by Corporation C as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing and Controlled 1 represents each corporation's present operation, and, with regard to each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Immediately after the First Distribution, the gross assets of the businesses conducted directly by Distributing and Controlled 1, and not by any subsidiaries of those corporations, will have a fair market value of at least five percent of the total fair market value of each corporation's gross assets, including the stock of each corporation's subsidiaries, if any.
- (e) Following the First Distribution, Distributing and Controlled 1 each will continue the active conduct of its business independently and with its separate employees.
- (f) The First Distribution will be carried out to achieve significant cost savings. See Rev. Proc. 96-30, Appendix A, § 2.04, 1996-1 C.B. 696, 710-11. The First Distribution is motivated, in whole or substantial part, by this corporate business purpose. The First Distribution is also motivated by a desire to accomplish a geographic realignment.
- (g) Except for the transfer of Controlled 1 stock from Disregarded to Holdco in the Fifth Contribution, there is no plan or intention by Corporation C or Disregarded to sell, exchange, transfer by gift, or otherwise dispose of any of its stock in either Distributing or Controlled 1 after the First Distribution.
- (h) There is no plan or intention by either Distributing or Controlled 1, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the First Distribution.

(i) There is no plan or intention to liquidate Distributing or Controlled 1, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the First Distribution, except in the ordinary course of business.

(j) No intercorporate debt will exist between Distributing and Controlled 1 at the time of, or subsequent to, the First Distribution except for an intercompany loan owed by Distributing to Controlled 1 of \$ f bearing an arms-length interest rate and trade receivables owed by Distributing to Controlled 1 which arose in the ordinary course of business.

(k) Distributing does not join in the filing of a consolidated federal return.

(l) Payments made in all continuing transactions between Distributing (or one or more of its subsidiaries) and Controlled 1 (or one or more of its subsidiaries) will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(m) Pursuant to § 355(e)(2)(C), the First 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 (not including a member of the Parent affiliated group as defined in § 1504 without regard to § 1504(b)) 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 1, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled 1.

First Contribution and Second Distribution Representations

Parent has made the following representations concerning the First Contribution and the Second Distribution:

- (n) Controlled 2 will not be indebted to Distributing after the Second Distribution.
- (o) No part of the consideration distributed by Distributing will be received by Corporation C as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (p) The five years of financial information submitted on behalf of Distributing and each of the Indicated Affiliates represents each corporation's present operation, and, with regard to each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (q) Immediately after the Second Distribution, at least 90 percent of the fair market value of the gross assets of Controlled 2 will consist of the stock and securities of controlled corporations (the Indicated Affiliates) that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (r) Immediately after the Second Distribution, the gross assets of the businesses conducted directly by Distributing and each of the Indicated Affiliates, and not by any subsidiaries of those corporations, will have a fair market value of at least five percent of the total fair market value of each corporation's gross assets, including the stock of each corporation's subsidiaries, if any.
- (s) Following the Second Distribution, Distributing and Controlled 2 (through the Indicated Affiliates) each will continue the active conduct of its business independently and with its separate employees.
- (t) The Second Distribution will be carried out to achieve significant cost savings. The Second Distribution is motivated, in whole or substantial part, by this corporate business purpose. The Second Distribution is also motivated by a desire to accomplish a geographic realignment.
- (u) Except for the transfer of Controlled 2 stock from Disregarded to Holdco in the Fifth Contribution, there is no plan or intention by Corporation C or Disregarded to sell, exchange, transfer by gift, or otherwise dispose of any of its stock in either Distributing or Controlled 2 after the Second Distribution.
- (v) There is no plan or intention by either Distributing or Controlled 2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Second Distribution.

(w) There is no plan or intention to liquidate Distributing or Controlled 2, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Second Distribution, except in the ordinary course of business.

(x) Controlled 2 will not assume any liabilities or receive any assets subject to liabilities as a result of, or in connection with, the First Contribution.

(y) The proposed transaction does not involve, and will not result in, a situation in which one party recognizes income but another party the deductions associated with that income, or one party owns property but another party recognizes the income associated with that property.

(z) No intercorporate debt will exist between Distributing and Controlled 2 at the time of, or subsequent to, the Second Distribution.

(aa) Distributing does not join in the filing of a consolidated federal return.

(bb) Payments made in all continuing transactions between Distributing (or one or more of its subsidiaries) and Controlled 2 (or one or more of its subsidiaries) will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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

(dd) Pursuant to § 355(e)(2)(C), the Second 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 (not including a member of the Parent affiliated group as defined in § 1504 without regard to § 1504(b)) 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 2, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled 2.

Other Representations

Parent has made the following additional representations:

(ee) Each of the Second Contribution, the Third Contribution, the Fourth Contribution (with respect to the interests in Corporation B and Corporation D), and the Fifth Contribution will constitute an exchange described in §§ 351(a) and 368(a)(1)(B).

(ff) The Fourth Contribution (with respect to the interests in Sub 5, Sub 6, and Sub 7) will constitute an exchange described in § 351(a).

(gg) The Holdco preferred stock issued in the Fifth Contribution will not be nonqualified preferred stock under § 351(g).

(hh) Disregarded, a disregarded entity of Corporation C pursuant to § 301.7701-2(b)(8)(ii)(A) of the Income Tax Regulations, will remain a disregarded entity of Corporation C under that provision for the 60-month period beginning with the date of the proposed restructuring transactions, except to the extent necessitated by a change in U.S. or Country A law relating to the classification of Disregarded as (1) a disregarded entity for U.S. federal tax purposes or (2) a corporation for Country A tax purposes.

(ii) In effectuating the proposed restructuring transactions, Parent does not have a principal purpose to achieve different tax results or consequences under foreign and U.S. law that are inconsistent with the purposes of U.S. tax law.

(jj) Parent has no plan or intent to have any additional partners, shareholders, or owners (other than members of the Parent affiliated group) in Disregarded, Holdco, including the Country B branch of Holdco, Controlled 1, or Controlled 2.

(kk) Controlled 2, Disregarded, Newco, and Holdco each was formed in anticipation of the transaction and neither Controlled 2, Disregarded, Newco, nor Holdco will have conducted any business prior to the transaction.

Rulings

Based solely on the information submitted and on the representations set forth above, and provided that the requirements of the temporary and final regulations under § 367(b) are satisfied (including the notice provisions of §§ 1.367(b)-1(c)(1) and 7.367(b)-1(c)(2) through (d)), we rule as follows regarding the proposed transaction:

Characterization for Federal Income Tax Purposes

(1) For federal income tax purposes, steps (ii) - (ix) of the proposed transaction described above will be treated as if Distributing distributed all the stock of Controlled 1 to Corporation C in the First Distribution, and, after the First Contribution, distributed all the stock of Controlled 2 to Corporation C in the Second Distribution (Rev. Rul. 83-142, 1983-2 C.B. 68; Rev. Rul. 77-191, 1977-1 C.B. 94; Rev. Rul. 67-448, 1967-2 C.B. 144).

First Distribution Rulings

(2) No gain or loss will be recognized by Distributing on the First Distribution (§ 355(c)(1) and (e)(2)(C); Rev. Rul. 98-27, 1998-22 I.R.B. 4).

(3) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Corporation C on the First Distribution (§ 355(a)(1); Rev. Rul. 98-27, 1998-22 I.R.B. 4).

(4) The holding period of the Controlled 1 stock received by Corporation C in the First Distribution will include the period during which Corporation C held the Distributing stock on which the First Distribution will be made, provided the Distributing stock is held as a capital asset on the date of the First Distribution (§ 1223(1)).

(5) The First Distribution will be an exchange to which § 7.367(b)-10(c) of the Temporary Income Tax Regulations applies and the requirements of paragraphs (d) through (h) of § 7.367(b)-10 must be satisfied.

First Contribution and Second Distribution Rulings

(6) The First Contribution followed by the Second Distribution will be a reorganization under § 368(a)(1)(D) (§ 368(a)(2)(H)(ii); Rev. Rul. 98-44, 1998-37 I.R.B. 4). Distributing and Controlled 2 each will be “a party to a reorganization” under § 368(b).

(7) No gain or loss will be recognized by Distributing on the First Contribution (§§ 361(a) and 357(a)).

(8) No gain or loss will be recognized by Controlled 2 on the First Contribution (§ 1032(a)).

(9) The basis of the stock of each of the Indicated Affiliates received by Controlled 2 in the First Contribution will equal the basis of the stock of each of the Indicated Affiliates in the hands of Distributing immediately before the First Contribution (§ 362(b)).

(10) The holding period of the stock of each of the Indicated Affiliates received by Controlled 2 in the First Contribution will include the period during which Distributing held the stock of each of the Indicated Affiliates (§ 1223(2)).

(11) No gain or loss will be recognized by Distributing on the Second Distribution (§§ 361(c)(1) and 355(e)(2)(C)).

(12) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Corporation C on receipt of the Controlled 2 stock in the Second Distribution (§ 355(a)(1); Rev. Rul. 98-27, 1998-22 I.R.B. 4; Rev. Rul. 98-44, 1998-37 I.R.B. 4).

(13) The holding period of the Controlled 2 stock received by Corporation C in

the Second Distribution will include the holding period of the Distributing stock on which the Second Distribution will be made, provided the Distributing stock is held as a capital asset on the date of the Second Distribution (§ 1223(1)).

(14) The Second Distribution will be an exchange to which § 7.367(b)-10(c) of the Temporary Income Tax Regulations applies and the requirements of paragraphs (d) through (h) of § 7.367(b)-10 must be satisfied.

Other Rulings

(15) The earnings and profits of Corporation B, to the extent attributable to such stock under § 1.1248-2 or 1.1248-3 (whichever is applicable) which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, during the period Parent held Corporation B stock (or was considered as holding it by reason of the application of § 1223) while Corporation B was a controlled foreign corporation shall be attributable to such stock held by Corporation A (§ 1.1248-1(a)(1)).

(16) The earnings and profits of Corporation B and Corporation D, to the extent attributable to the stock of each respective corporation under § 1.1248-2 or 1.1248-3 (whichever is applicable) which were accumulated in taxable years of each respective foreign corporation beginning after December 31, 1962, during the period Corporation A held Corporation B and Corporation D stock, respectively (or was considered as holding it by reason of the application of § 1223) while Corporation B or Corporation D was a controlled foreign corporation shall be attributable to such stock held by Corporation C (§ 1.1248-1(a)(1)).

(17) The earnings and profits of Corporation B, Corporation D, Controlled 1, Controlled 2, Sub 5, Sub 6, and Sub 7, to the extent attributable to the stock of each respective corporation under § 1.1248-2 or 1.1248-3 (whichever is applicable) which were accumulated in taxable years of each respective foreign corporation beginning after December 31, 1962, during the period Corporation C held Corporation B, Corporation D, Controlled 1, Controlled 2, Sub 5, Sub 6, and Sub 7 stock, respectively (or was considered as holding it by reason of the application of § 1223) while Corporation B, Corporation D, Controlled 1, Controlled 2, Sub 5, Sub 6, or Sub 7 was a controlled foreign corporation shall be attributable to such stock held by Holdco (§ 1.1248-1(a)(1)).

Caveats

We express no opinion about the tax treatment of the transaction under any other provision of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction not specifically covered by the above rulings. In particular, we express no opinion as to: (a) treatment

of the Pre-Transaction Dividend; (b) the application of § 306 to the preferred stock to be issued by Holdco in the Fifth Contribution; (c) whether Parent may claim a foreign tax credit under § 901 on any tax imposed by Country A on any amounts distributed under Country A law from Disregarded to Corporation C; or (d) except as specifically described in rulings (15) - (17), the Second Contribution, the Third Contribution, the Fourth Contribution, or the Fifth Contribution.

The rulings in this letter are based on the facts and representations submitted under penalties of perjury in support of the request. Verification of that information may be required as part of the audit process.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter (including regulations under § 358(g)) have not yet been adopted. Therefore, this ruling letter will be modified or revoked if adopted temporary or final regulations are inconsistent with any conclusions in the ruling letter. See § 12.04 of Rev. Proc. 98-1, 1998-1 I.R.B. 7, 47-48. However, when the criteria in § 12.05 of Rev. Proc. 98-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Procedural Matters

This ruling has no effect on any earlier document and is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each taxpayer involved in the proposed transaction must attach a copy of this letter to the federal income tax return of the taxpayer for the taxable year in which the transaction is completed.

Pursuant to a power of attorney on file in this office, we are forwarding a copy of this letter to the taxpayer.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By _____
Robert T. Hawkes
Assistant to the Chief, Branch 4