

## Internal Revenue Service

## Department of the Treasury

Index Number: 0355.00-00 , 0368.00-00  
0355.01-00, 0367.10-04

Washington, DC 20224

Number: **199915027**

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Release Date: 4/16/1999

Telephone Number:

Refer Reply To:

**CC:DOM:CORP:5 PLR-118028-98**

Date:

**January 11, 1999**

Re:

Parent =

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

F Sub =

Business A =

Business B =

State Y =

State Z =

Country X =

Dear

This is in reply to a letter dated September 9, 1998, requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was received on December 1, 1998 and January 7, 1999. The material submitted for consideration is summarized below.

Parent is a State Z corporation, the stock of which is widely held and publicly traded. Parent is the common parent of a consolidated group that files, together with its includible affiliates, a consolidated federal income tax return. Parent is engaged, through its affiliates, in the conduct of Business A and Business B in the United States and in Country X.

Distributing is a Country X corporation and is engaged in the conduct of Business A and Business B. Parent has owned all of the outstanding shares of Distributing for the past 5 years.

Sub 1 is a State Y corporation and is engaged in the conduct of Business A. All of the outstanding shares of Sub 1 are owned by Parent.

Sub 2, a State Z corporation, is a holding company that, through its subsidiaries, is engaged in the conduct of Business B. Parent has owned all of the outstanding shares of Sub 2 for more than 5 years.

Sub 3 is a State Y corporation and is engaged in the conduct of Business B. All of the outstanding shares of Sub 3 are owned by Sub 2.

Sub 4 is a State Y corporation and is engaged in the conduct of Business B. All of the outstanding shares of Sub 4 are owned by Sub 3.

F Sub is a Country X corporation and is engaged in the conduct of Business B. All of the outstanding shares of F Sub are owned by Sub 3.

Parent has submitted data indicating that both Business A and Business B

conducted by Distributing have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past 5 years.

There are dramatic differences in the cultures, needs and business perspectives of Business A and Business B. In order to permit the resolution of management, systemic and other problems that are exacerbated by the operation of Business A and Business B within a single corporation, it is proposed that Business A and Business B be conducted by independent groups of companies, both of which would be under the general oversight of Parent. Parent's management has determined that the establishment of two independent companies to conduct each of Business A and Business B will enable management of each to enhance the success of its respective business by permitting management to resolve such problems and to focus on the specific needs and objectives of its business.

Accordingly, the following transaction is proposed:

- (i) Sub 2 will liquidate into Parent.
- (ii) Parent will form Controlled, a new Country X corporation, and transfer to it a nominal amount of capital in exchange for all of Controlled's issued and outstanding voting common stock.
- (iii) Distributing will transfer Business B to Controlled.
- (iv) Parent will transfer the stock of Controlled to Sub 3.
- (v) Sub 3 will merge with and into Sub 4 with Sub 4 receiving the assets of Sub 3, namely its Business B ("Sub 3 Business B") and the stock of Controlled and F Sub.
- (vi) Sub 4 will form a new U.S. corporation ("Newco") and transfer to it the Sub 3 Business B in exchange for all of Newco's issued and outstanding voting common stock.
- (vii) Parent will transfer the shares of Distributing to Sub 1.

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) Any indebtedness owed by Controlled to Distributing after the distribution of the Controlled stock will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Distributing will be received by Parent as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.

- (c) The 5 years of financial information submitted on behalf of Distributing's Business A is representative of the corporation's present operations, and with regard to Business A, 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 Distributing's Business B is representative of the corporation's present operations, and with regard to Business B, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the transaction, Distributing and Controlled will each continue the active conduct of its businesses, independently and with its separate employees.
- (f) The distribution of the stock of Controlled is carried out to allow each of Distributing and Controlled to focus its management attention and capital on maximizing the profitability of Business A and Business B, respectively. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (g) There is no plan or intention by Parent to sell, exchange, transfer by gift, or otherwise dispose of any of its stock in, or securities of, either Distributing or Controlled after the transaction, except for the contribution of the stock of Distributing and Controlled to lower tier U.S. subsidiaries of Parent.
- (h) 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.
- (i) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities to be assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (j) The liabilities to be assumed in the transaction and the liabilities to which the assets to be transferred are subject, were incurred in the ordinary course of business and are associated with the assets to be transferred.
- (k) Except for the possibility that short term intercompany liabilities may exist immediately following the transaction in order to accomplish an appropriate division of property, no intercorporate debt will exist between

Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.

- (l) 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.
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) 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 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.
- (o) Neither Distributing nor Controlled is a passive foreign investment company as defined in § 1297.
- (p) Distributing is and Controlled will be a controlled foreign corporation within the meaning of § 957(c).
- (q) The transfer by Parent of the Controlled stock to Sub 3 will qualify as a § 351 transfer.
- (r) The transfer by Parent of the Distributing stock to Sub 1 will qualify as a § 351 transfer.

Based solely on the information submitted and the representations set forth above, and provided that (i) Distributing and Controlled are each corporations within the meaning of § 7701(a)(3); (ii) Distributing and Controlled are each controlled foreign corporations within the meanings of § 957(a); and (iii) the requirements of paragraphs (c) and (d) of the Temporary Income Tax Regulations § 7.367(b)-1 and all of the conditions and requirements of §§ 7.367(b)-4 through 7.367(b)-12 are met, we hold as follows:

- (1) For federal income tax purposes, the transactions described in steps (ii) and (iii) will be treated as if Distributing formed Controlled, transferred its Business B assets to Controlled in exchange for Controlled common stock and the assumption by Controlled of Distributing's liabilities associated with Business B, and Distributing distributed all of the stock of Controlled to Parent (Rev. Rul. 77-191, 1977 C.B. 94).

- (2) The transfer by Distributing to Controlled of its Business B assets and the assumption by Controlled of Distributing's liabilities associated with such assets, followed by the distribution of all of the stock of Controlled to Parent 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).
- (3) No gain or loss will be recognized to Distributing on the transfer of its Business B assets to Controlled in exchange for all of the stock of Controlled and Controlled's assumption of the liabilities associated with such assets (§§ 361(a) and 357(a)).
- (4) No gain or loss will be recognized by Controlled upon the receipt of the assets from Distributing in exchange for all of the outstanding stock of Controlled and Controlled's assumption of liabilities (§ 1032(a)).
- (5) The basis of the assets transferred to Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the transfer (§ 362(b)).
- (6) The holding period of the assets received by 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) Parent on its receipt of the stock of Controlled (§ 355(a)).
- (8) No gain or loss will be recognized by Distributing upon the distribution to Parent of all of the stock of Controlled (§ 361(c)(1)).
- (9) The basis of the stock of Distributing and Controlled in the hands of Parent 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)(2) of the Income Tax Regulations (§ 358(a)(1)).
- (10) The holding period of the Controlled stock received by Parent 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 asset on the date of the distribution (§ 1223(1)).
- (11) The distribution of the stock of Controlled by Distributing is an exchange to which paragraphs (a) and (c) of § 7.367(b)-10 apply (§ 7.367(c)-1).

- (12) The earnings and profits of Controlled, 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 Controlled stock (or was considered as holding it by reason of the application of § 1223) while Controlled was a controlled foreign corporation, will be attributable to such stock held by Sub 3 (§ 1.1248-1(a)).
- (13) The earnings and profits of Distributing, 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 Distributing stock (or was considered as holding it by reason of the application of § 1223) while Controlled was a controlled foreign corporation, will be attributable to such stock held by Sub 1 (§ 1.1248-1(a)).

If the requirements and conditions of § 7.367(b)-10 are not complied with, the Commissioner shall make a determination whether, and to the extent, Controlled will be considered to be a corporation based on all the facts and circumstances surrounding the failure to comply (§ 7.367(b)-1(b)).

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.

No opinion is expressed with respect to whether any or all of the above-described foreign corporations are passive foreign investment companies within the meaning of § 1297(a) and the regulations to be promulgated thereunder. 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 opinion is expressed as to the application of § 1248 to the transfer of the Controlled and the F Sub stock to Sub 4 in step (iv) above. Finally, no opinion is expressed 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.

This ruling letter is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. Each affected taxpayer must attach a copy of this letter to the federal income tax return for the taxable year in which the transaction covered by this letter ruling is consummated.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By \_\_\_\_\_

Filiz A. Serbes

Assistant to the Chief, Branch 5