

**Internal Revenue Service**

Department of the Treasury

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Distributing =

Controlled =

State A =

State B =

State C =

State D =

A =

B =

X =

Y =

Z =

E =

Family =

Business C =

Business D =

Date 1 =

Country B =

Subsidiary 1 =

Subsidiary 2 =

Subsidiary3 =

Subsidiary 4 =

Subsidiary 5 =

Subsidiary 6 =

Subsidiary 7 =

Subsidiary 8 =

Subsidiary 9 =

Subsidiary 10 =

Subsidiary 11 =

Subsidiary 12 =

Dear :

We respond to your letter dated October 26, 1998, in which you requested rulings under § 355 of the Internal Revenue Code. The information submitted in that letter and later correspondence is summarized below.

Distributing, a State A corporation, is the parent of a consolidated group of corporations and uses the accrual method of accounting. Distributing has two classes of stock, stock of which approximately A shares are outstanding and stock of which approximately B shares are outstanding. The stock is widely held and publicly traded. The stock controls approximately X percent of the total voting power of Distributing and is almost exclusively owned by Family. Distributing and its subsidiaries are engaged in two businesses, Business C and Business D, both in the United States and in other countries including Country B.

Among Distributing's subsidiaries are Subsidiaries 1-10 and Controlled. Subsidiary 1, a State B corporation, is a wholly-owned, first-tier subsidiary of Distributing and is engaged in both Business C and Business D. Subsidiaries 2, 4, and 5, State C corporations, are wholly-owned first-tier subsidiaries of Distributing and are engaged in Business D only. Subsidiaries 3, 7, 8, and 9, State A subsidiaries, are also wholly-owned, first-tier subsidiaries of Distributing and are engaged in Business D only. Subsidiary 6, a State D corporation, is also a wholly-owned, first-tier subsidiary of Distributing and is engaged in Business D only. Subsidiary 10, a Country B corporation, is currently owned Y percent by Subsidiary 6 and Z percent by Subsidiary 8 and is engaged in both Business C and Business D. Controlled, a State A corporation, was formed on Date 1 for purposes of the proposed transaction. Controlled has two classes of stock, stock and stock.

Distributing has determined that it needs to borrow \$E to meet the scheduled and anticipated obligations of Business C. Distributing has been experiencing problems borrowing such funds. Several rating agencies have downgraded Distributing's credit rating due to its ownership of Business D significantly increasing Distributing's cost of borrowing. Accordingly, Distributing intends to separate its two businesses by transferring Business D to Controlled and then distributing Controlled to its shareholders in a proposed transaction with the following steps:

- (1) Subsidiary 10 will form Subsidiary 11, a Country B corporation, and will transfer all of its assets associated with Business D to Subsidiary 11 in exchange for all of the Subsidiary 11 stock.
- (2) Subsidiary 10 will then undergo a recapitalization issuing pro rata to its shareholders, in exchange for the currently outstanding Subsidiary 10 stock, new and stock (reorganization shares) redeemable for an amount equal to the fair market value of the Business D assets transferred to Subsidiary 11.
- (3) Subsidiary 6 and Subsidiary 8 will form Subsidiary 12, a Country B corporation, and will transfer to Subsidiary 12 the reorganization shares of Subsidiary 10 in exchange for the Y percent and Z percent of the Subsidiary 12 stock, respectively.
- (4) Subsidiary 10 will then transfer to Subsidiary 12, all of the stock of Subsidiary 11 in exchange for stock in Subsidiary 12 (the "special shares") having a fair market value equal to the Subsidiary 11 stock.
- (5) Subsidiary 10 will redeem its reorganization shares by issuing to Subsidiary 12 a non-interest bearing note in the amount of the redemption value of the reorganization shares.
- (6) Subsidiary 12 will redeem its special shares by assigning back to Subsidiary 10 the note issued by Subsidiary 10 in redemption of the reorganization shares.
- (7) Immediately thereafter, Subsidiary 11 will be liquidated into Subsidiary 10 and dissolved.
- (8) Subsidiary 6 and Subsidiary 8 will then distribute the stock of Subsidiary 10 to Distributing.
- (9) Subsidiary 1 which holds certain intangibles associated with both Business C and Business D will liquidate into Distributing. Subsequently, the intangibles associated with Business D will be transferred to Controlled.
- (10) Distributing then will transfer the stock of Subsidiaries 2, 3, 4, 5, 6, 7, 8 and 9 to Controlled in exchange for Controlled and Controlled stock (the contributions). The stock of Controlled will then be distributed pro rata to the shareholders of Distributing.

The taxpayer has supplied financial information which indicates that Distributing and Controlled will each be conducting a business that has had gross receipts and operating expenses representative of the active conduct of the business for each of the

past five years.

The following representations have been made in connection with the proposed transaction:

- (a) Distributing will pay the expenses incurred in the proposed transaction.
- (b) No part of the consideration distributed by Distributing will be received by a shareholder of Distributing as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) Following the distribution, Distributing and Controlled will each continue the active conduct of its respective business, independently and with separate employees.
- (d) The total adjusted basis and the fair market value of the assets to be transferred to Controlled in the contributions will, in each instance, equal or exceed the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (e) The liabilities assumed by Controlled in the contributions and the liabilities to which the transferred assets are subject will have been incurred in the ordinary course of business and will be associated with the transferred assets.
- (f) The distribution of the stock of Controlled is carried out for the corporate business purpose of facilitating Distributing to borrow funds necessary to meet scheduled and anticipated obligations of Business C.
- (g) The management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular shareholder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the distribution.
- (h) The five years of financial information submitted for Business C and Business D represent the present operations of each respective business, and regarding each business, there has been no substantial operational change since the date of the last financial statement submitted.
- (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 any of the assets of either corporation after the proposed transactions, except in the ordinary course of business.
- (j) None of the transferred assets will be subject to investment tax credit recapture.

- (k) Any indebtedness owed by Controlled to Distributing after the distribution of Controlled stock will not be stock or securities under § 355.
- (l) Payments made in all continuing transactions 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 transactions are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) Except in connection with a stock repurchase program, 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 distribution other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.
- (o) Immediately before the distribution, items of income, gain, loss, deduction and credit, if any, will be taken into account as required by the applicable intercompany regulations. (See § 1.1502-13 and § 1.1502-14 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). Distributing will not have an excess loss account in the stock of any corporation that will leave the Distributing consolidated group in the distribution.
- (p) The distribution is not part of a plan or series of related transactions (within the meaning of section 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.
- (q) The gross assets of the trades or businesses relied on to satisfy the active trade or business requirement of § 355(b) for both the distribution of Controlled and the distribution of Subsidiary 12 will have a fair market value that is at least 5 percent of the total fair market value of the gross assets of the corporation directly conducting the trade or businesses.
- (r) More than 80% of the value of the outstanding stock of Controlled will be distributed with respect to the outstanding stock of Distributing that is regularly traded on an established securities market.
- (s) Distributing does not know, or have reason to know, of any foreign person that owns a 5% or greater interest in either class of Distributing stock.

- (t) Distributing will comply with the notice requirements of § 1.367(e)-1T(c)(2)(iii).

Based solely on the information submitted and the representations made, we rule as follows:

- (1) Steps 1-8 of the proposed transaction will be treated as the transfer by Subsidiary 10 of its Business C assets to Subsidiary 12 followed by the distribution of Subsidiary 12 stock to Subsidiary 6 and Subsidiary 8. (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).
- (2) The transfer by Distributing of the assets and liabilities of Business C to Controlled in exchange for all the stock of Controlled followed by the distribution of all of the Controlled stock to the shareholders of Controlled constitutes a reorganization within the meaning of § 368(a)(1)(D) of the Code. 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 by Distributing as a result of the transfer of the assets of Business C to Controlled for the Controlled stock and the assumption by Controlled of the Business C liabilities. (§§ 361(a) and 357(a))
- (4) No gain or loss will be recognized by Controlled on the receipt of the assets of Business C in exchange for the stock of Controlled. (§ 1032(a))
- (5) The basis of each asset received by Controlled will be, in each instance, the same as the basis of such asset in the hands of Distributing immediately prior to the distribution. (§ 362(b))
- (6) The holding period of the Business D 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 be included in the income of, Distributing, on the distribution of shares of Controlled to the Distributing shareholders. (§§ 361(c))
- (8) No gain or loss will be recognized by, and no amount will otherwise be included in the income of, the Distributing shareholders on their receipt of Controlled stock in the distribution. (§ 355(a)(1))
- (9) The aggregate basis of the Controlled stock and the Distributing stock in the hands of the shareholders of Distributing, immediately following the distribution, will be the same as the 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). (§ 358(b)(2))

- (10) The holding period of the Controlled stock received by each Distributing shareholder will be the holding period of the Distributing stock or Distributing stock as to which the distribution is made, provided that the Distributing stock or the Distributing stock is held as a capital asset 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 under § 1.312-10(a) and 1.1502-33.
- (12) No gain or loss will be recognized by, and no amount will be included in the income of Subsidiary 10, on the deemed distribution of shares of Subsidiary 12 to its shareholders. (§ 355(c)) No gain or loss will be recognized by, and no amount will be included in the income of the Subsidiary 10 shareholders, Subsidiary 6 and Subsidiary 8 on the exchange. (§ 355(a)(1))
- (13) The earnings and profits of Subsidiary 12, 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 Subsidiary 10 held (or was deemed to have held) the Subsidiary 12 stock (or was considered as holding it by reason of the application of § 1223) while Subsidiary 12 was a controlled foreign corporation shall be attributable to the Subsidiary 12 stock in the hands of Subsidiary 6 and Subsidiary 8. Section 1.1248-1(a)(1).
- (14) The deemed distribution of the Subsidiary 12 stock to Subsidiary 6 and Subsidiary 8 is subject to, the extent applicable, the rules of paragraph (c) of § 1.367(b)-1 of the Income Tax Regulations, paragraphs (c) and (d) of § 7.367(b)-1 of the Temporary Regulations, and § 7.367(b)-10 of the Temporary Regulations.
- (15) The earnings and profits of Subsidiary 10, 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 Subsidiary 6 and Subsidiary 8 held the Subsidiary 10 stock (or was considered as holding it by reason of the application of § 1223) while Subsidiary 10 was a controlled foreign corporation shall be attributable to the Subsidiary 10 stock in the hands of Distributing. Section 1.1248-1(a)(1).
- (16) The distribution of the Subsidiary 10 stock to Distributing is subject to, to the extent applicable, the rules of paragraph (c) of § 1.367(b)-1 of the Income Tax

Regulations, paragraphs (c) and (d) of § 7.367(b)-1 of the Temporary Regulations and § 7.367(b)-10 of the Temporary Regulations.

- (17) Provided that (1) Distributing satisfies the requirements of Temp. Reg. § 1.367(e)-1T(c)(2)(i); (2) Distributing complies with the reporting requirement described in § 1.367(e)-1T(c)(2)(iii); and (3) Distributing does not know or have reason to know that any shareholder of Distributing who is not a qualified U.S. person (as defined in § 1.367(e)-1T(b)(1)(i)) is a 5% shareholder of Distributing (as described in § 1.367(e)-1T(c)(2)(ii)), no gain will be recognized by Distributing under § 367(e)(1), with respect to the Distribution by Distributing of the stock of Controlled to Distributing's shareholders.

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.

Temporary or final regulations pertaining to one or more of the issues addressed in this letter ruling (including regulations under § 358(g)) have not been adopted. Therefore, this ruling will be modified or revoked if adopted temporary or final regulations are inconsistent with any conclusions in this letter ruling. See § 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 47-48. However, when the criteria in § 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

This ruling is directed only to the taxpayer who requested it. Section 6610(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling is consummated.

Sincerely Yours,

Assistant Chief Counsel (Corporate)

By \_\_\_\_\_  
Mark S. Jennings  
Senior Technician Reviewer  
CC:DOM:CORP:1