

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Refer Reply To:
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Date:
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Distributing =

Controlled =

State A =

Date B =

Date C =

Date D =

Date E =

Date F =

Date G =

Date H =

Date I =

Date J =

Date K =

Country Y =

Country Z =

Retained Businesses =

Business 1 =

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Sub 1 =

Sub 2 =

Sub 3 =

Trademark =

Transition Services =

Transaction Agreements =

a =

b =

c =

d =

e =

f =

g =

h =

i =

k =

m =

This letter responds to a request dated June 1, 2000 for rulings about the federal income tax treatment of a proposed transaction. We have received additional information in letters dated July 20, 2000, September 11, 2000, and September 21, 2000. The information submitted for consideration is summarized below.

Distributing is a publicly traded State A corporation and the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year basis using an accrual method of accounting. Distributing has one class

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of common stock issued and outstanding. Distributing is directly engaged in the Retained Businesses and indirectly engaged in additional businesses through various domestic and foreign subsidiaries. Distributing has no 5 percent shareholders.

On Date B, Distributing formed Controlled when Distributing contributed the Business 1 to Controlled in exchange for Controlled common stock. Controlled is a wholly owned subsidiary of Distributing and a member of Distributing's consolidated group. Controlled has one class of common stock authorized and outstanding. Controlled uses an accrual method of accounting.

Distributing directly operated the Business 1 beginning in Date C. Since Date B, Controlled has directly operated the Business 1. Controlled also conducts the Business 1 through a number of foreign and domestic subsidiaries, including its wholly owned subsidiaries, Sub 1 and Sub 2, and Sub 3 of which Controlled owns an a% interest.

Financial information has been received which indicates that the Retained Businesses and the Business 1 each has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Distributing has concluded and information has been received indicating the existence of substantial differences in the managerial philosophies of the Retained Businesses and the Business 1 that have arisen in operating such businesses under a single corporate umbrella. Information has been provided indicating that the Retained Businesses and the Business 1 are distinct and that the aforementioned differences require that the product lines of the Retained Businesses and the Business 1 be operated separately to enhance their success.

To accomplish these objectives, the taxpayer has proposed and partially consummated the following transaction (the "Proposed Transaction"):

- (1) On Date D, Sub 1 forgave \$b of approximately \$c owed by Distributing to Sub 1 under a promissory note between Distributing and Sub 1 (the "Distributing Note"). On Date E, Distributing paid Sub 1 all of the remaining principal and interest due under the Distributing Note (the "Distributing Note Proceeds").
- (2) On Date F and Date G, Distributing contributed to Controlled its interests in Sub 1, Sub 2, and Sub 3, and intellectual property used in the Business 1. On or about Date H, Distributing contributed to Controlled its remaining Business 1 assets, including Trademark, and Controlled assumed any liabilities of Distributing associated with the Business 1 (together, except for Trademark, the "Contribution").
- (3) On Date G, Controlled declared a dividend of \$d to Distributing.

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- (4) Sub 1 formed indirect foreign subsidiaries (the “Sub 1 Foreign Subsidiaries”) and contributed to them a portion of the Distributing Note Proceeds.
- (5) Prior to the distribution in step (10), below, the Sub 1 Foreign Subsidiaries will purchase, at fair market value, foreign assets used in the Business 1 from various indirect foreign subsidiaries of Distributing. In addition, Controlled’s Country Y subsidiary and its Country Z branch will sell, at fair market value, assets used in businesses other than the Business 1 to Distributing’s two foreign subsidiaries.
- (6) On Date I, Controlled consummated a stock split whereby the number of its shares of common stock issued and outstanding was increased from e to f.
- (7) On Date J, Controlled completed an initial public offering (“IPO”) of its common stock. In the IPO, Controlled sold g shares of common stock for approximately \$h net proceeds. In addition, on Date K, the underwriters fully exercised their option to purchase an additional j shares from Controlled for \$k. The total IPO

proceeds to Controlled thus equaled \$m. Following the IPO and the underwriters’ purchase of the additional j shares of Controlled common stock, Distributing owned a greater than 80% interest in Controlled.

- (8) On Date K, Controlled distributed to Distributing \$d in full payment of the previously declared dividend by Controlled to Distributing (the “Dividend Distribution”). Distributing segregated the proceeds of the Dividend Distribution in a special bank account.
- (9) Also on Date K, Distributing used all \$d of the dividend proceeds received from Controlled to retire \$d of its commercial paper.
- (10) Distributing will distribute all of its stock of Controlled pro rata to its shareholders, except Distributing will not distribute fractional share interests of Controlled common stock. Instead, fractional shares, if any, will be aggregated and sold on the open market at then-prevailing prices by the transfer agent, a party independent from Distributing and Controlled. The transfer agent will then distribute to each shareholder of Distributing who would otherwise be entitled to receive a fractional share interest in Controlled such shareholder’s portion of the cash proceeds (the “Distribution”).

With respect to the Proposed Transaction, the taxpayer has made the following representations:

- (a) The indebtedness, if any, owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

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- (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) The 5 years of financial information submitted on behalf of Distributing is representative of Distributing's present operation, and with regard to such corporation, 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 Controlled is representative of Controlled's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the Proposed Transaction, Distributing and Controlled will each continue the active conduct of its business(es), independently and with its separate employees, except that following the Distribution, Distributing will provide Transition Services to Controlled for an interim period, generally for one year or less.
- (f) The Distribution will be carried out for the following corporate business purpose: to enable Controlled to enhance the success of the Business 1 by enabling it to resolve management, systemic and employee-related problems arising from operating in the Distributing affiliated group. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (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, except for sales by employee benefits plans of Distributing and Controlled.
- (h) 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.
- (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 each equals or exceeds the sum of the liabilities

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- assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (k) The liabilities, if any, assumed by Controlled in the Proposed Transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
 - (l) No investment credit has been (or will be) claimed for any of the property transferred to Controlled in the Proposed Transaction.
 - (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, except for claims arising under Transaction Agreements.
 - (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's excess loss account, if any, with respect to the Controlled common stock and the excess loss account, if any, with respect to the stock of any subsidiary owned by Controlled directly or indirectly, will be included in income immediately before the Distribution.
 - (o) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled (and their respective subsidiaries), will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's-length.
 - (p) The Distribution is not part of a plan or a 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.
 - (q) No two parties to the transaction are investment companies as defined in §§ 368(a)(2)(F)(iii) and (iv).
 - (r) Neither Distributing nor Controlled was a United States real property holding corporation (as defined in § 897(c)(2)) at any time in the five-year period ending on the date of the Distribution, and neither Distributing nor Controlled will be a United States real property holding corporation immediately after the Proposed Transaction.
 - (s) The payment of cash in lieu of fractional share interests of Controlled, if any, is solely to avoid the expense and inconvenience of issuing fractional share

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interests, and does not represent separately bargained-for consideration. The total cash received in lieu of fractional share interests of Controlled stock will be less than 1 percent of the total fair market value of the Controlled stock distributed by Distributing. No Distributing shareholder will receive cash for more than one full share of Controlled stock.

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

- (1) The transfer of assets pursuant to the Contribution (as described in step 2, above) by Distributing to Controlled solely in exchange for the stock of Controlled, the assumption by Controlled of related liabilities, and cash from the Dividend Distribution followed by the Distribution and the transfer of such cash solely to Distributing's creditors (as described in step 9, above) constitutes a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be a "party to the reorganization" within the meaning of § 368(b).
- (2) Distributing will recognize no gain or loss on the transfer of assets pursuant to the Contribution to Controlled, subject to liabilities, in exchange for Controlled stock, the assumption by Controlled of related liabilities, and the receipt of cash from the Dividend Distribution which was solely distributed to Distributing's creditors. Sections 357(a), 361(a), 361(b)(1)(A), and 361(b)(3).
- (3) Controlled will recognize no gain or loss on the receipt of assets pursuant to the Contribution in exchange for Controlled stock. Section 1032(a).
- (4) The basis of the assets received by Controlled pursuant to the Contribution will be equal to the basis of such assets in the hands of Distributing immediately before the transaction. Section 362(b).
- (5) The holding period for each asset received by Controlled pursuant to the Contribution will include the period during which such asset was held by Distributing. Section 1223(2).
- (6) Distributing will recognize no gain or loss upon the distribution of the Controlled common stock (including any fractional share interest of Controlled) to the shareholders of Distributing. Section 361(c).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing upon the receipt of the Controlled common stock (including any fractional share interest to which they may be entitled) distributed to them in the Distribution. Section 355(a)(1).
- (8) The aggregate basis of Distributing and Controlled stock (including any fractional share interest to which they may be entitled) in the hands of each

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Distributing shareholder after the Distribution will, in each instance, equal the basis of the Distributing stock held by such shareholder immediately before the Distribution, allocated between the Distributing stock and Controlled stock in proportion to the relative fair market value of each in accordance with § 1.358-2(a)(2). Sections 358(a), (b), and (c).

- (9) The holding period of the Controlled stock (including any fractional share interest to which they may be entitled) that each Distributing shareholder receives will include the holding period of the Distributing common stock with respect to which the Distribution will be made, provided the Distributing stock is held as a capital asset by such shareholder on the date of the Distribution. Section 1223(1).
- (10) Proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with §§ 1.312-10(a) and 1.1502-33.
- (11) Where cash is received by a Distributing shareholder in lieu of fractional share interests of Controlled common stock, Distributing will be treated as distributing the fractional share to the shareholder and such fractional share will be treated as having been disposed of by such shareholder for the amount of such cash in a sale or exchange. The gain (or loss), if any, will be treated as a capital gain (or loss), provided such stock was held as a capital asset by the selling Distributing shareholder. Section 1001.

Except as expressly provided herein, no opinion is expressed concerning the federal tax consequences of the proposed transaction under any other provision of the Code and regulations which may be applicable thereto, or as to the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction which are not specifically covered by the above rulings.

No opinion is expressed as to the federal income tax consequences of the transfer of Trademark by Distributing to Controlled in the Proposed Transaction.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

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A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely yours,
Associate Chief Counsel (Corporate)

By Ken Cohen

Acting Chief, Branch 3