

Internal Revenue Service

Department of the Treasury

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Date:

October 9, 2001

Parent =

S1 =

S2 =

Distributing =

Controlled =

F1 =

F2 =

F3 =

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F4 =

Business l =

Business m =

Business n =

Country A =

Country B =

Country C =

Country D =

Date 1 =

Date 2 =

Date 3 =

Year 4 =

Year 5 =

\$G =

E =

F =

We respond to your letter dated April 10, 2001, for rulings concerning the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated May 24, June 28, and September 25, 2001. The material information submitted for consideration is summarized below.

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Parent, a publicly traded domestic corporation, is the common parent of a consolidated group as well as an affiliated group containing numerous foreign subsidiaries. Parent wholly owns S1, a domestic holding company. S1 wholly owns S2, a domestic holding company, whose only asset consists of all of Distributing's common and junior preferred stock. Distributing, incorporated under the laws of Country A, wholly owns numerous subsidiaries, of which the following are relevant for the transaction proposed herein: F1, a Country B entity; F2, a Country C corporation; and F4, a Country D entity. F2 wholly owns F3, a Country C entity.

Parent is engaged in Business l. F1, F2 and F3 together are engaged in Business m and are disregarded entities for federal income tax purposes pursuant to an election under § 301.7701-3. F4 is engaged in Business n and, until the effective date of the proposed transaction, is treated as a division of Distributing for United States tax purposes. Distributing uses the accrual method of accounting for its federal income tax return and has a taxable year ending on Date 1 for federal income tax and foreign income tax purposes. F4 has a taxable year ending on Date 1 for foreign income tax purposes and, subsequent to the proposed transaction, will use a taxable year ending on Date 1 for federal income tax purposes.

We have received financial information indicating that Business m and Business n each have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Multiple levels of foreign withholding taxes exist under the above-described organizational structure. Accordingly, the directors of Parent propose to engage in the following proposed transaction:

- (i) Pursuant to an election made by Parent under § 7701 and § 301.7701-3 on Date 3, Distributing will be deemed to transfer to Controlled all of the assets of F4 in exchange for all of the shares of Controlled common stock and the assumption by Controlled of the liabilities of F4. Controlled will be treated as a corporation under U. S. federal income tax law (hereinafter referred to as the "Contribution").
- (ii) Distributing will undergo a tax-free demerger transaction under Country A law. Accordingly, by operation of Country A law, Distributing will be split into two Country A companies, New Distributing 1 and New Distributing 2, with New Distributing 1 coming into existence owning all the shares of Controlled, and New Distributing 2 owning all the remaining assets and liabilities of Distributing (hereinafter referred to as the "Demerger"). By operation of Country A law, shares of common stock of New Distributing 1 and New Distributing 2 will be allocated to S2 based on the fair market value of the assets owned by New Distributing 1 and New Distributing 2 as of Date 3, and Distributing's class of

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junior preferred stock will be allocated in the amount of E in Country A currency to New Distributing 1 and in the amount of E in Country A currency to New Distributing 2.

(iii) Immediately after the Demerger, New Distributing 1 will adopt a plan of liquidation and will be dissolved as soon as possible under Country A law (hereinafter referred to as the "Distribution").

Following the proposed transaction, S2 will own all of the common stock of Controlled, and New Distributing 2 will own all of the remaining assets and liabilities of Distributing (other than the shares of Controlled) and will become known as Distributing. This proposed transaction will result in significant cost savings for Parent and its subsidiaries.

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

- (a) Any indebtedness owed by Controlled to Distributing after the distribution of Controlled stock will not constitute stock or securities.
- (b) Immediately after the Distribution, the gross assets of Distributing comprising Business m will have a fair market value that is equal to or greater than five percent of the total fair market value of the gross assets of Distributing.
- (c) Immediately after the Distribution, the gross assets of Controlled comprising Business n will have a fair market value that is equal to or greater than five percent of the total fair market value of the gross assets of Controlled.
- (d) 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 the corporation.
- (e) The five years of financial information submitted on behalf of Business m and Business n is representative of each business' respective present operations, and, with regard to each business, there has been no substantial operational changes since the date of the last financial statements submitted, except for the transfer of certain assets by F4 to a wholly owned Country D subsidiary in a transaction unrelated to, and having no effect upon, the proposed transaction.
- (f) Following the Distribution, Distributing and Controlled each will continue the active conduct of its business, independently and with its separate

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employees.

- (g) The Distribution is to be carried out for the corporate business purpose of achieving cost savings, namely the reduction of foreign withholding taxes. The Distribution is motivated, in whole or substantial part, by this corporate business purposes.
- (h) There is no plan or intention by the shareholder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of its stock, or securities of, Distributing or Controlled after the transaction.
- (i) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any stock of Distributing or Controlled after the transaction.
- (j) 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.
- (k) The total adjusted bases and the fair market value of the assets transferred pursuant to the Contribution will be equal or exceed the sum of the liabilities to be assumed (as determined under § 357(d)) by Controlled, if any, plus any liabilities to which the transferred assets are subject.
- (l) The liabilities assumed in the Contribution (as determined under § 357(d)), if any, 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.
- (m) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (n) No intercorporate debt will exist between Distributing and its subsidiaries, and Controlled and its subsidiaries, at the time of, or subsequent to, the Distribution, other than trade and royalty receivables/payables having arm's length terms and incurred in the ordinary course of Distributing's and Controlled's respective businesses, and a revolving credit agreement that Controlled may enter into with Distributing or a subsidiary of Distributing.
- (o) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be based on terms and conditions arrived at by the parties bargaining at arm's length.

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- (p) Neither Distributing nor Controlled is an investment company as defined in §§ 368(a)(2)(F)(iii) and (iv).
- (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 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.
- (r) Less than 50 percent of the total combined voting power of all classes of Distributing stock entitled to vote and less than 50 percent of the total value of shares of all classes of Distributing stock will have been acquired by purchase under §§ 355(d)(5) or (8) during the five-year period ending on the date of the Distribution (determined after applying § 355(d)(6)).
- (s) Neither Distributing nor Controlled is a passive foreign investment company as defined in § 1297(a).
- (t) Both Distributing and Controlled are, or will be at the time of the Distribution, corporations as defined in § 7701(a)(3).
- (u) Both Distributing and Controlled are, or will be at the time of the Distribution, and will continue to be after the Distribution, controlled foreign corporations (“CFCs”) within the meaning of § 957(a).
- (v) Parent is a United States shareholder (within the meaning of § 1.367(b)-3(b)(2)) with respect to both Distributing and Controlled.
- (w) Neither Distributing nor Controlled has been or will be a United States real property holding company (“USRPHC”), as defined in § 897(c)(2), at any time during the five-year period ending on the date of the proposed transaction, and neither of them will be a USRPHC immediately thereafter.
- (x) The notice requirement of § 1.367(b)-1(c)(1) will be met with regard to the proposed transaction.

The following additional facts relate to Distributing’s earnings and profits: As of Date 2, Distributing has a hovering earnings and profits deficit of \$G, which it succeeded to when F3 elected under § 301.7701-3 to be treated as a disregarded entity (hereinafter the “F3 Deficit”). F3 cannot make distributions under Country C law because it has insufficient earnings. Parent expects F3 will continue to be unable to

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distribute such amounts until F3 generates positive earnings and profits.

The taxpayers have made the following additional representations regarding Distributing's earnings and profits:

- (y) All prior year earnings of Distributing (including those of Controlled during the period that it has been disregarded as an entity separate from Distributing) have been distributed, generally on an annual basis.
- (z) All prior year earnings of Distributing's subsidiaries generally have been distributed on an annual basis.
- (aa) Any subpart F income of Distributing or its subsidiaries that has given rise to previously taxed income (within the meaning of § 959) has been distributed, and any foreign tax credits associated with such subpart F income have been claimed.
- (bb) Neither Distributing nor Controlled will have any previously taxed income immediately before the Distribution or immediately before the Contribution, except that Distributing will have previously taxed income solely attributable to distributions received from its subsidiaries in the current year.
- (cc) Except for the F3 Deficit, there are no foreign taxes in the post- Year 4 pool of taxes or the pre- Year 5 annual layer of taxes of either Distributing or Controlled.

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

- (1) For federal tax purposes the proposed transaction will be treated as if Distributing transferred the assets of F4 to Controlled in exchange for all of the stock of Controlled and the assumption by Controlled of the liabilities of F4, followed immediately by a distribution of all of the Controlled stock to S2 (cf. Rev. Rul. 77-191, 1977-1 C.B. 94). The Contribution followed by the Distribution will constitute 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).
- (2) Distributing will recognize no gain or loss upon the Contribution and the assumption by Controlled of certain liabilities (§§ 361(a) and 357(a)).
- (3) Controlled will recognize no gain or loss on the Contribution (§ 1032(a)).

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- (4) Controlled's basis in each asset received in the Contribution will be equal to the basis of such asset in the hands of Distributing immediately prior to the transfer (§ 362(b)).
- (5) Controlled's holding period for each asset received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).
- (6) Distributing will recognize no gain or loss on the distribution of the Controlled common stock to S2 pursuant to the Distribution (§ 361(c)(1)).
- (7) S2 will recognize no gain or loss (and no amount will be included in S2's income) upon receipt of Controlled common stock pursuant to the Distribution (§ 355(a)(1)).
- (8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of S2 will equal the basis of the Distributing stock held by S2 immediately prior to the Distribution, allocated between the Distributing and Controlled stock in proportion to the fair market value of each immediately after the Distribution in accordance with § 1.358-2(a)(4).
- (9) The holding period of the Controlled stock received by S2 in the Distribution will include the holding period of the Distributing stock, provided that S2 held such stock of Distributing as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) of the Income Tax Regulations as of Date 3.

Based solely on the information submitted and the representations as set forth above, and provided that Distributing and Controlled are each a corporation within the meaning of § 7701(a)(3) and the requirements of § 1.367(b)-1(c) are met, we hold as follows:

- (11) The Contribution is an exchange described in § 1.367-4(a).
- (12) The Distribution is a distribution to which §§ 1.367(b)-5(a) and (c) apply.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the proposed transaction under any other provision 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.

The rulings contained in this letter are predicated upon the facts and

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representations submitted by the taxpayers 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. See section 12.04 of Rev. Proc. 2001-1, 2001-1 I.R.B. 1, 46, which discusses in greater detail the revocation or modification of ruling letters. However, when the criteria in section 12.05 of Rev. Proc. 2001-1, 2001-1 I.R.B. at 47, are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

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.

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 letter is consummated.

Pursuant to a power of attorney on file in this office, a copy of this letter has been sent to each of your authorized representatives.

Sincerely yours,
Filiz A. Serbes
Chief, Branch 3
Office of Associate Chief Counsel
(Corporate)