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Holding Company 2 =

Shareholder 1 =

Shareholder 2 =

Other Shareholders =

Business A =

Business B =

State X =

Year 1 =

a =b% =c% =d% =e% =f% =

Date 1 =

Date 2 =

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Date 3 =

Date 4 =

Agency =

Dear

This letter is in reply to your authorized representative's letter dated August 4, 2003, requesting rulings as to the federal income tax consequences with respect to a series of proposed transactions. Additional information was received in subsequent letters dated October 20, 2003, November 19, 2003, December 8, 2003, and January 29, 2004. The material information submitted for consideration is summarized below.

SUMMARY OF FACTS

Parent is a State X corporation incorporated in Year 1. Parent currently has a shares of voting common stock outstanding. The outstanding shares are held by Shareholder 1 (b%), Shareholder 2 (b%), and Other Shareholders (c%) (collectively, "the Shareholders"). Parent is engaged in Business A.

Parent owns 100% of the outstanding common stock of Distributing, a State X corporation. Distributing, in turn, wholly owns Controlled 1 and Controlled 2 (sometimes referred to herein collectively as the "Controlled Corporations"), each State X corporations. Distributing and the Controlled Corporations are each engaged in various aspects of Business B.

Parent, Distributing, and the Controlled Corporations each use the accrual method of accounting. Parent has a taxable year ending on Date 1. Distributing and the Controlled Corporations are calendar year taxpayers. Parent and Distributing have each owned the stock for their respective corporations for more than five years.

We have received financial information which indicates that Parent, Distributing, and the Controlled Corporations have each been conducting a business that has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

On Date 2, Limited Partnership was formed as a State X limited partnership. General Partner, a newly formed corporation owned equally by Shareholder 1 and Shareholder 2, will own a d% general partnership interest in Limited Partnership. The remaining e% limited partnership interest will be owned by the Shareholders (with

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Shareholder 1 and Shareholder 2 each owning $f\%$ and Other Shareholders owning $g\%$). On Date 3, Holding Company 1 was incorporated as a State X corporation. On Date 4, Holding Company 2 was formed as a State X corporation. All of the stock of Holding Company 1 and Holding Company 2 will be held by Limited Partnership.

Parent has provided substantiation that the separation of Distributing from Parent (as a result of the First Spin-Off, described below) will protect Parent from the risks inherent in Distributing's business. The litigious nature of Distributing's business exposes Parent to significant liabilities. In addition, Parent has provided substantiation that significant cost savings will be produced if Parent is no longer the parent corporation of Distributing. Agency is requiring a financial audit of the parent company of Distributing. Parent has provided substantiation showing that Parent can significantly reduce its audit costs by engaging in the First Spin-Off. The projected period cost savings exceed one percent of the base period net income of Parent's affiliated group (as defined in Rev. Proc. 96-30, Appendix A, section 2.04).

Parent has also provided substantiation that the separation of Controlled 1 and Controlled 2 from Distributing will protect Controlled 1 and Controlled 2 from the risks inherent in Distributing's business. The litigious nature of Distributing's business also exposes Controlled 1 and Controlled 2 to significant liabilities. The insurance policy of Distributing does not protect the stock of Controlled 1 and Controlled 2, or the assets of Controlled 1 and Controlled 2. In addition, Distributing has demonstrated that additional insurance that might provide such coverage is either unavailable or prohibitively expensive. Further, Parent has provided substantiation that the separation of Controlled 1 and Controlled 2 from Distributing will better position the Controlled Corporations for expansion.

Accordingly, the following steps have been proposed by the taxpayers:

- (i) The Shareholders will transfer all of their stock in Parent to Limited Partnership in exchange for the limited partnership interests (the "Partnership Contribution").
- (ii) Parent will distribute all of stock of Distributing to Limited Partnership (the "First Spin-Off").
- (iii) Distributing will distribute all of the stock of Controlled 1 and Controlled 2 to Limited Partnership (the "Second Spin-Off").
- (iv) Limited Partnership will transfer the stock of Distributing to Holding Company 1 in exchange for the stock of Holding Company 1 (the "First Contribution").

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- (v) Limited Partnership will transfer the stock of Controlled 2 to Holding Company 2 in exchange for the stock of Holding Company 2 (the "Second Contribution").

REPRESENTATIONS

The taxpayers have made the following representations in connection with the First Spin-Off:

- (a) Any indebtedness owed by Distributing to Parent after the distribution of the stock of Distributing will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Parent will be received by Limited Partnership as a creditor, employee, or in any capacity other than that of a shareholder of Parent.
- (c) The five years of financial information submitted on behalf of Parent and Distributing is representative of 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) Following the transaction, Parent and Distributing will each continue the active conduct of its business, independently and with its separate employees, except that the services of Shareholder 1 and Shareholder 2 will be shared.
- (e) The distribution of the stock of Distributing is carried out for the following corporate business purpose: risk reduction and cost savings. The distribution of the stock of Distributing is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) Parent is not an S corporation and there is no plan or intention by Parent or Distributing to make an S corporation election pursuant to section 1362(a).
- (g) There is no plan or intention by Limited Partnership to sell, exchange, transfer by gift, or otherwise dispose of any of its stock in Parent, Distributing, or Holding Company 1 after the proposed transaction.

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- (h) There is no plan or intention by either Parent or Distributing, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (i) There is no plan or intention to liquidate either Parent or Distributing, 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.
- (j) Parent neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the proposed transaction.
- (k) No intercorporate debt will exist between Parent and Distributing at the time of, or subsequent to, the distribution of the Distributing stock, except for debt arising in the ordinary course of business.
- (l) Payments made in connection with all continuing transactions, if any, between Parent and Distributing, 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 proposed transaction are investment companies as defined in section 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 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 Parent or Distributing, or stock possessing 50 percent or more of the total value of all classes of stock of Parent or Distributing.

The taxpayers have made the following representations in connection with the Second Spin-Off:

- (a) Any indebtedness owned by Controlled 1 or Controlled 2 to Distributing after the distribution of the stock of Controlled 1 and Controlled 2 will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Distributing will be received by Limited Partnership as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

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- (c) The five years of financial information submitted on behalf of Distributing, Controlled 1, and Controlled 2 is representative of 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) Following the transaction, Distributing, Controlled 1, and Controlled 2 will each continue the active conduct of its business, independently and with its separate employees.
- (e) The distribution of the stock of Controlled 1 and Controlled 2 is carried out for the following corporate business purposes: risk reduction. The distribution of the stock of Controlled 1 and Controlled 2 is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (f) Distributing is not an S corporation and there is no plan or intention by Distributing, Controlled 1, or Controlled 2 to make an S corporation election pursuant to section 1362(a).
- (g) There is no plan or intention by Limited Partnership to sell, exchange, transfer by gift, or otherwise dispose of any of its stock in either of Distributing, Controlled 1, Controlled 2, Holding Company 1, or Holding Company 2 after the proposed transaction.
- (h) There is no plan or intention by Distributing, Controlled 1, or Controlled 2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (i) There is no plan or intention to liquidate Distributing, Controlled 1, or Controlled 2, to merge any of the corporations 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.
- (j) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the proposed transaction.
- (k) No intercorporate debt will exist between Distributing, Controlled 1, and Controlled 2 at the time of, or subsequent to, the distribution of the Controlled 1 and Controlled 2 stock, except for debt arising in the ordinary course of business.

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- (l) Payments made in connection with all continuing transactions, if any, between Distributing, Controlled 1, and Controlled 2, 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 proposed transaction are investment companies as defined in section 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 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 Distributing, Controlled 1, or Controlled 2, or stock possessing 50 percent or more of the total value of all classes of stock of Distributing, Controlled 1, or Controlled 2.

The taxpayers have made the following representations in connection with the First Contribution:

- (a) No stock or securities will be issued for services rendered to or for the benefit of Holding Company 1 in connection with the proposed transaction.
- (b) No stock or securities will be issued for indebtedness of Holding Company 1 that is not evidenced by a security or for interest on indebtedness of Holding Company 1 which accrued on or after the beginning of the holding period of Limited Partnership's debt.
- (c) The transfer is not the result of the solicitation by a promoter, broker or investment house.
- (d) Limited Partnership will not retain any rights in the property transferred to Holding Company 1.
- (e) No debt or liabilities of Limited Partnership is being assumed by Holding Company 1 and no assets are being transferred to Holding Company 1 subject to any debt or liabilities of Limited Partnership in connection with the transaction.
- (f) The adjusted basis and the fair market value of the assets to be transferred by Limited Partnership to Holding Company 1 will, in each

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instance, be equal to or exceed the sum of liabilities assumed by Holding Company 1 plus any liabilities to which the assets are subject.

- (g) There is no indebtedness between Holding Company 1 and Limited Partnership and there will be no indebtedness created in favor of Limited Partnership as a result of the transaction.
- (h) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.
- (i) All exchanges will occur on approximately the same date.
- (j) There is no plan or intention on the part of Holding Company 1 to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.
- (k) Taking into account any issuance of additional shares of Holding Company 1 stock; any issuance of stock for services; the exercise of any Holding Company 1 stock rights, warrants, or subscriptions; a public offering of Holding Company 1 stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of Holding Company 1 to be received in the exchange, Limited Partnership will be in "control" of Holding Company 1 within the meaning of section 368(c).
- (l) Limited Partnership will receive stock approximately equal to the fair market value of the property transferred to Holding Company 1 or for services rendered or to be rendered for the benefit of Holding Company 1.
- (m) Holding Company 1 will remain in existence and retain and use the property transferred to it in a trade or business of Holding Company 1 or its subsidiary, Distributing.
- (n) There is no plan or intention by Holding Company 1 to dispose of the transferred property other than in the normal course of business operations.
- (o) Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the proposed transaction.
- (p) Limited Partnership is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of section 368(a)(3)(A)) and the stock

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received in the exchange will not be used to satisfy any indebtedness of Limited Partnership.

- (q) Holding Company 1 will not be a personal service corporation within the meaning of section 269A.

The taxpayers have made the following representations in connection with the Second Contribution:

- (a) No stock or securities will be issued for services rendered to or for the benefit of Holding Company 2 in connection with the proposed transaction.
- (b) No stock or securities will be issued for indebtedness of Holding Company 2 that is not evidenced by a security or for interest on indebtedness of Holding Company 2 which accrued on or after the beginning of the holding period of Limited Partnership's debt.
- (c) The transfer is not the result of the solicitation by a promoter, broker or investment house.
- (d) Limited Partnership will not retain any rights in the property transferred to Holding Company 2.
- (e) No debt or liabilities of Limited Partnership is being assumed by Holding Company 2 and no assets are being transferred to Holding Company 2 subject to any debt or liabilities of Limited Partnership in connection with the transaction.
- (f) The adjusted basis and the fair market value of the assets to be transferred by Limited Partnership to Holding Company 2 will, in each instance, be equal to or exceed the sum of liabilities assumed by Holding Company 2 plus any liabilities to which the assets are subject.
- (g) There is no indebtedness between Holding Company 2 and Limited Partnership and there will be no indebtedness created in favor of Limited Partnership as a result of the transaction.
- (h) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.
- (i) All exchanges will occur on approximately the same date.

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- (j) There is no plan or intention on the part of Holding Company 2 to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.
- (k) Taking into account any issuance of additional shares of Holding Company 2 stock; any issuance of stock for services; the exercise of any Holding Company 2 stock rights, warrants, or subscriptions; a public offering of Holding Company 2 stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of Holding Company 2 to be received in the exchange, Limited Partnership will be in "control" of Holding Company 2 within the meaning of section 368(c).
- (l) Limited Partnership will receive stock approximately equal to the fair market value of the property transferred to Holding Company 2 or for services rendered or to be rendered for the benefit of Holding Company 2.
- (m) Holding Company 2 will remain in existence and retain and use the property transferred to it in a trade or business of Holding Company 2 or its subsidiary, Controlled 2.
- (n) There is no plan or intention by Holding Company 2 to dispose of the transferred property other than in the normal course of business operations.
- (o) Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the proposed transaction.
- (p) Limited Partnership is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of section 368(a)(3)(A)) and the stock received in the exchange will not be used to satisfy any indebtedness of Limited Partnership.
- (q) Holding Company 2 will not be a personal service corporation within the meaning of section 269A.

RULINGS

Based solely on the information submitted and the representations as set forth above, with respect to the Partnership Contribution we hold as follows:

- (1) The contribution of the Parent stock to Limited Partnership would not be treated as a transfer to an investment company under section 351 if

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Limited Partnership were incorporated. Therefore, Shareholder 1, Shareholder 2, and Other Shareholders of Parent will recognize no gain or loss upon the contribution of their Parent stock to Limited Partnership (section 721).

- (2) The basis of the partnership interests in Limited Partnership that the Shareholders of Parent will receive in exchange for their stock of Parent will be the same as their basis in the Parent stock at the time of the transfer (section 722).
- (3) Limited Partnership's basis in the Parent stock contributed by the Shareholders of Parent will be the same as the basis of the Parent stock in the hands of the Shareholders at the time of transfer (section 723).
- (4) The holding period for the partnership interests in Limited Partnership that the Shareholders of Parent will receive in exchange for their Parent stock will include the period those shareholders owned the Parent stock (section 1223(1)).
- (5) Limited Partnership's holding period for the Parent stock contributed by the Shareholders of Parent will include the periods those shareholders owned the stock (section 1223(2)).

Based solely on the information submitted and the representations as set forth above, with respect to the First Spin-Off we hold as follows:

- (1) No gain or loss will be recognized by Parent upon the distribution of all of the stock of Distributing in the First Spin-Off (section 355(c)(1)).
- (2) No gain or loss will be recognized by (and no amount will be included in the income of) the Parent shareholders (Limited Partnership) upon the receipt of the stock of Distributing (section 355(a)(1)).
- (3) The aggregate basis of the Parent and Distributing shares in the hands of the Parent shareholders (Limited Partnership) immediately after the First Spin-Off will be the same as the aggregate basis of the Parent stock in the hands of the Parent shareholders (Limited Partnership) immediately before the First Spin-Off, allocated between the Parent and Distributing shares in proportion to the fair market value of each in accordance with section 1.358-2(a)(2) (sections 358(a), (b), and (c)).
- (4) The holding period of the Distributing shares in the hands of the Parent

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shareholders (Limited Partnership) will include the holding period of the Parent shares with respect to which the First Spin-Off is made, provided the Parent shares are held as a capital asset by such shareholder on the date of the First Spin-Off (section 1223(1)).

- (5) As provided in section 312(h), proper allocation of earnings and profits between Parent and Distributing will be made in accordance with section 1.312-10(a).

Based solely on the information submitted and the representations as set forth above, with respect to the Second Spin-Off we hold as follows:

- (1) No gain or loss will be recognized by Distributing upon the distribution of all the stock of Controlled 1 and Controlled 2 in the Second Spin-Off (section 355(c)(1)).
- (2) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders (Limited Partnership) upon the receipt of the stock of Controlled 1 and Controlled 2 (section 355(a)(1)).
- (3) The aggregate basis of the Distributing, Controlled 1, and Controlled 2 shares in the hands of the Distributing shareholders (Limited Partnership) immediately after the Second Spin-Off will be the same as the aggregate basis of the Distributing stock in the hands of the Distributing shareholders (Limited Partnership) immediately before the Second Spin-Off, allocated between the Distributing, Controlled 1, and Controlled 2 shares in proportion to the fair market value of each in accordance with section 1.358-2(a)(2) (sections 358(a), (b), and (c)).
- (4) The holding period of the Controlled 1 and Controlled 2 shares in the hands of the Distributing shareholders (Limited Partnership) will include the holding period of the Distributing shares with respect to which the Second Spin-Off is made, provided the Distributing shares are held as a capital asset by such shareholder on the date of the Second Spin-Off (section 1223(1)).
- (5) As provided in section 312(h), proper allocation of earnings and profits between Distributing, Controlled 1, and Controlled 2 will be made in accordance with section 1.312-10(a).

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Based solely on the information submitted and the representations as set forth above, with respect to the First Contribution we hold as follows:

- (1) Limited Partnership will recognize no gain or loss on the First Contribution (section 351(a)).
- (2) Holding Company 1 will recognize no gain or loss on the First Contribution (section 1032(a)).
- (3) The basis of the stock of Distributing in the hands of Holding Company 1 will equal the basis of the stock in the hands of Limited Partnership immediately before the First Contribution (section 362(a)(1)).
- (4) The holding period of the stock of Distributing received by Holding Company 1 in the First Contribution will include the holding period of the stock in the hands of Limited Partnership (section 1223(2)).

Based solely on the information submitted and the representations as set forth above, with respect to the Second Contribution we hold as follows:

- (1) Limited Partnership will recognize no gain or loss on the Second Contribution (section 351(a)).
- (2) Holding Company 2 will recognize no gain or loss on the Second Contribution (section 1032(a)).
- (3) The basis of the stock of Controlled 2 received by Holding Company 2 will equal the basis of the stock in the hands of Limited Partnership immediately before the Second Contribution (section 362(a)(1)).
- (4) The holding period of the stock of Controlled 2 received by Holding Company 2 in the Second Contribution will include the holding period of the stock in the hands of Limited Partnership (section 1223(2)).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

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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.

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

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

Sincerely,

Victor L. Penico
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(Corporate)