

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:B06-PLR-143672-01

Date:

December 13, 2001

LEGEND

Foreign Parent =

Domestic Parent =

Distributing =

Controlled =

Business 1 =

Business 2 =

Business 3 =

State X =

State Y =

This letter responds to your letter, dated August 15, 2001, submitted on behalf of Domestic Parent requesting rulings under I.R.C. § 355 with respect to a proposed transaction. Additional information was submitted in a letter dated November 19, 2001. The information submitted is summarized below.

Foreign Parent owns all of the stock of Domestic Parent. Domestic Parent is the common parent of an affiliated group of corporations filing a consolidated Federal income tax return. Domestic Parent owns all of the stock of Distributing, and

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Distributing owns all of the stock of Controlled. Domestic Parent secures financing for the members of its group. Distributing is engaged in Business 1, and Controlled is engaged in Business 2 and Business 3.

Domestic Parent has proposed the following transaction to achieve the business purpose described below:

- (1) Distributing will distribute all of the Controlled stock to Domestic Parent.
- (2) Domestic Parent will cause Controlled to convert into a single member limited liability company ("LLC") either through (i) a merger of Controlled into a newly formed single member LLC, or (ii) a conversion under the applicable state LLC law. The conversion will result in Controlled being treated as a disregarded entity under Treas. Reg. § 301.7701-3(b)(1)(ii).
- (3) Immediately after the conversion of Controlled into an LLC, Domestic Parent will transfer all of the issued and outstanding stock of Distributing to Controlled (now an LLC).

The proposed transaction will reduce state tax burdens in three distinct ways. First, since Controlled's operations will be treated as conducted by Domestic Parent, Controlled's income will be combined with Domestic Parent's losses (from interest expenses) in states that calculate tax liability based on an entity's separate activities within that state. Thus, Controlled's operations will no longer be subject to tax in these states because, as part of Domestic Parent, its income will be offset by Domestic Parent's losses.

Second, the property, payroll and sales of Controlled will dilute Domestic Parent's apportionment percentages for State X franchise tax purposes and thereby reduce the amount of State X franchise taxes paid.

Third, because of the substantial intercompany activity between Distributing and Controlled, the transfer of Controlled to Domestic Parent will enable the filing of a State Y Tax Return. Previously, Domestic Parent and its subsidiaries filed separately from Distributing and its subsidiaries in State Y.

The following representations have been made in connection with step (1) of the proposed transaction:

- (a) The indebtedness, if any, owed by Domestic Parent (as successor to Controlled) to Distributing after the distribution will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Distributing will be received by Domestic Parent as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Business 1,

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Business 2 and Business 3 is representative of each business's present operations, and with regard to each business, there have been no substantial operational changes since the date of the last financial statements submitted.

- (d) Following the proposed transaction, Distributing and Domestic Parent (as successor to Controlled) will each continue the active conduct of its business, independently and with its separate employees.
- (e) The distribution of the Controlled stock is carried out for the following corporate business purpose: To provide the Domestic Parent group a significant state tax savings. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) Except for the plan of merger/conversion of Controlled, there is no plan or intention by Domestic Parent to sell, exchange, transfer by gift, or otherwise dispose of any of its stock in, or securities of, Distributing or Controlled after the proposed transaction. There is no plan or intention by Foreign Parent to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, Domestic Parent after the proposed transaction.
- (g) There is no plan or intention by Distributing, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the proposed transaction, other than through stock purchases meeting the requirements of section 4.05(1) of Rev. Proc. 96-30. There is no plan or intention by Domestic Parent, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the proposed transaction, other than through stock purchases meeting the requirements of section 4.05(1) of Rev. Proc. 96-30.
- (h) Except for the plan of merger/conversion of Controlled, there is no plan or intention to liquidate Distributing or Domestic Parent, to merge Distributing or Domestic Parent with any other corporation, or to sell or otherwise dispose of the assets of Distributing or Controlled or Domestic Parent after the proposed transaction, except in the ordinary course of business.
- (i) Payments made in connection with all continuing transactions, if any, between Distributing and Domestic Parent (as successor to Controlled) will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (j) There are no deferred intercompany items with respect to the shares of Controlled stock owned by Distributing. There is no excess loss account with respect to the shares of Controlled stock owned by Distributing, and Domestic Parent (as the successor to Controlled) will remain a member of the Domestic Parent consolidated group.
- (k) 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

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voting power of all classes of stock of either Domestic Parent or Distributing or stock possessing 50 percent or more of the total value of all classes of stock of either Domestic Parent or Distributing.

Based solely on the information submitted and on the representations set forth above, it is held as follows:

1. No gain or loss will be recognized by Distributing from the distribution of Controlled stock to Domestic Parent (section 355(c)).
2. No gain or loss will be recognized by (and no amount will be included in the income of) Domestic Parent upon the receipt of Controlled stock (section 355(a)(1)).
3. The aggregate basis of the Controlled and Distributing stock in the hands of Domestic Parent immediately after the distribution will be the same as the aggregate basis of the Distributing stock held by Domestic Parent immediately before the distribution, allocated between the Distributing and Controlled stock in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a) (section 358(a)(1) and (b)).
4. The merger/conversion of Controlled into a disregarded entity will not prevent step 1 of the proposed transaction from qualifying as a tax-free distribution of Controlled stock pursuant to section 355 (Treas. Reg. § 1.355-2(d)(2)(i); Commissioner v. Morris Trust, 367 F.2d 794 (4th Cir. 1966); Rev. Rul. 62-138, 1962-2 C.B. 95).
5. Earnings and profits will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. §§ 1.312-10 and 1.1502-33(e)(3).

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.

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. Specifically, no opinion is expressed concerning the tax consequences of steps (2) and (3) of the proposed transaction. Originally, you had asked us for a series of rulings concerning the tax consequences of step (2) of the proposed transaction. However, we decline because these rulings fall within an area in which rulings will not be issued. See § 3.01(29) of Rev. Proc. 2001-3, 2001-1 I.R.B. 111, 114.

This ruling is directed only to the taxpayer 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.

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

Sincerely,
Steven J. Hankin
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
(Corporate)

cc: