

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:B:06-PLR-161885-02

Date:

March 4, 2003

Distributing =

Controlled =

T1 =

T2 =

T3 =

T4 =

T4Sub =

T5 =

T6 =

T7 =

S1 =

S2 =

Business 1 =

Business 2 =

Business 3 =

Business 4 =

PLR-161885-02

Business 5 =

Business 6 =

Business Group A =

Business Group B =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

State V =

State W =

State X =

State Y =

State Z =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Year 1 =

Year 2 =

PLR-161885-02

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Year 7 =

Year 8 =

a =b =c =d =e =f =g =h =

Z =

Dear :

This letter responds to your letter dated November 8, 2002, requesting rulings under I.R.C. §§ 368 and 355. Additional information was received in letters dated December 23, 2002, January 10, 2003, February 4, 2003 and February 28, 2003. The information submitted in your letters is summarized below.

PLR-161885-02

Distributing is a State V Corporation that is the common parent of an affiliated group of corporations that file a consolidated federal income tax return. Distributing has two classes of stock issued and outstanding: voting common stock and stock. Distributing's common stock is publicly traded, widely held and listed on the Z. Shareholder 1 who is also Distributing's chief executive, owns five percent or more of the common stock of Distributing. Shareholder 1 also owns all of the stock. Shareholder 2 is an investment advisor who owns five percent or more of the common stock of Distributing. Shareholder 3 is an investment advisor who owns five percent or more of the common stock of Distributing. Shareholder 4 is an investment advisor who owns five percent or more of the stock of Distributing.

Distributing and its subsidiaries are engaged in six lines of business: Business 1, Business 2, Business 3, Business 4, Business 5 and Business 6. These businesses are conducted in the United States and in foreign countries. Distributing is directly engaged in Business 2 and Business 5. It also owns assets used in Business 4.

On Date 1, S1, a State W corporation wholly owned by Distributing, acquired all of the assets of T1, a State W corporation, which had been actively engaged in the conduct of Business 4 since Year 1, in a merger in exchange solely for Distributing common stock. S1 merged into Distributing on Date 2. On Date 3, S2, a State X corporation wholly owned by Distributing, acquired the assets of T2, a State X corporation, and T3, a State W corporation, through mergers in exchange solely for Distributing common stock. T2 had been engaged in the active conduct of Business 4 since Year 2. T3 had been engaged in the active conduct of Business 4 since Year 8. Prior to the distribution, S2 will merge into Distributing and Distributing will transfer the assets of T2 and T3 to Controlled. In Year 3, T4 acquired the stock of T4SUB in a tax free reorganization. The acquisition involved the formation by T4SUB of T4 which in turn formed a new subsidiary T7. As part of the plan of acquisition, T7 merged with and into T4SUB with T4Sub's shareholders receiving the stock of T4 in exchange for their stock of T4SUB. In addition, all of the stock that T4SUB held in T4 was cancelled in connection with the merger. At this time, T4 owned all of the stock of T4SUB, which had conducted Business 4 since Year 4. All of the stock of T4, a State Y publicly traded holding corporation, was acquired by Distributing on Date 4 in a transaction solely in exchange for Distributing common stock. T4 thereafter changed its name to Controlled. On Date 6, Distributing, acquired all of the stock of T5, a State Z corporation, solely in exchange for its common stock. T5 had conducted Business 4 since Year 5.

On Date 5, Distributing acquired in a taxable transaction all of the membership interests in T6, a State V limited liability company that was treated as a partnership for U.S. tax purposes, solely in exchange for its common stock. T6 had conducted Business 4 since Year 6.

PLR-161885-02

Distributing and its subsidiaries have used the assets of T1, T2, T3, T4SUB, T5 and T6 in the conduct of Business 4.

On Date 7, Distributing will have cash on hand in the amount of a. Distributing anticipates that of this amount b will be used to fund its operations in the first quarter of Year 7, that c to d will be contributed to Controlled prior to the distribution for its working capital and that the remaining e-f will be necessary to meet its own working capital requirements.

Controlled is a State Y corporation, which operates as a holding company. It owns subsidiaries that are directly or indirectly engaged in Business 4 in the United States and in foreign countries. Controlled has only a single class of common stock outstanding.

Financial information has been submitted which indicates that Business 2, Business 4 and Business 5 each 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 presented documentation showing that Business 3 and Business 4 (together Business Group A) are substantially different from and incompatible with Business 1 and Business 2 (together Business Group B). A significant segment of Business 1's customers are companies in direct competition with Business 3. These customers have expressed concern that Business 1 gives preferential treatment to its Business 3 affiliates and that using Business 1 increases Distributing's resources to expand Business 3 in competition with them. Several important customers of Business 1 have refused to renew their contracts, or reduced the amount of their business they do, with Business 1 because of its affiliation with Business 3, resulting in a significant amount of lost revenue for Business 1 and impeding its growth. Customers of Business Group A demanded that Distributing impose restrictions on the way the businesses of Business Group B are conducted.

Accordingly, to eliminate the conflicts described above and allow Business Group A and Business Group B to achieve their full potential, the following transactions are proposed:

- (i) Controlled will reincorporate in State V.
- (ii) Several wholly owned subsidiaries of Controlled conducting Business 4, including T4SUB, will merge into Controlled.
- (iii) Distributing will contribute its directly held assets used in Business 4 to Controlled and Controlled will assume the liabilities related to those assets. Some of these assets will have been distributed to Distributing prior to their contribution to Controlled.

PLR-161885-02

- (iv) Distributing will contribute the stock of its subsidiaries conducting Business 3 and Business 4 to Controlled. In some instances, such stock will have been distributed to Distributing in anticipation of its contribution to Controlled.
- (v) In exchange, Controlled will issue shares of common stock to Distributing.
- (vi) Controlled will elect a board of directors and officers independent of Distributing. No officer or director of Distributing, including Shareholder 1, will serve as an officer or director of Controlled.
- (vii) Following these preliminary transactions, Distributing will distribute all of the Controlled common stock to holders of its common and stock pro rata (the "Distribution").

In conjunction with the proposed transactions, Distributing and Controlled will enter into several agreements relating to their separation, including transitional service agreements and a tax sharing agreement. Such transitional service agreements relate to the continuing provision by Distributing to Controlled of administrative services, such as those related to taxes, legal, accounting and risk and human resources management, as well as computer systems and certain shared space. The transitional service agreements are not expected to last longer than 1 year.

Distributing has made the following representations regarding the proposed transaction:

- (a) 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.
- (b) The five years of financial information submitted on behalf of Business 2, 4 and 5, is representative of each such business's present operation, and with regard to each such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) At the time of the Distribution, the gross assets of the businesses that are relied on to satisfy the active business requirement of the regulations will have a fair market value that is at least five percent or more of the total fair market value of the corporation conducting the businesses.
- (d) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate officers and employees.

PLR-161885-02

- (e) The assets of T1, T2, and T3 and the stock of T4 and T5 were acquired by Distributing or its subsidiaries in transactions in which no gain or loss was recognized in whole or in part.
- (f) The Distribution is being carried out for the following corporate business purpose: to solve problems arising from the competition of clients of Business Group B with Business Group A. The Distribution is motivated, in whole or substantial part, by the foregoing corporate business purpose.
- (g) There is no plan or intention by any shareholder who owns five percent or more of the stock of Distributing, and the management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular remaining shareholder or security holder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the Distribution, except (i) for possible proportional dispositions by Shareholder 1 of Distributing common stock and Controlled common stock for personal reasons, which will constitute less than 9 percent of the total outstanding stock of Distributing and Controlled, (ii) sales of fractional shares of Controlled stock distributed in the Distribution and (iii) dispositions of certain restricted stock in Distributing that vest after the spin-off but only to the extent reasonably necessary to pay the total tax liability arising from the vesting of such stock. To the best of the knowledge of Distributing's management, the number of Distributing restricted shares sold upon vesting to satisfy such tax liability will not exceed the amount of stock that vests, the stock sold for this purpose will consist only of such vested stock and the sales will be evidenced by the transfer of stock certificates corresponding to the restricted stock. Notwithstanding the foregoing, Shareholder 2, Shareholder 3 and Shareholder 4 may in the future determine to dispose of or purchase any such stock in the normal course of their business as investment advisors based upon decisions as to existing market conditions and the needs of the investors they represent.
- (h) There is no plan or intention by either Distributing and 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 Section 4.05(1)(b) of Rev. Proc. 96-30.
- (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.

PLR-161885-02

- (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 assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (k) The liabilities assumed in the 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) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Distribution.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (n) Payments made in connection with 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.
- (o) 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 (See Reg. §1.1502-13 and §1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; Reg. §1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account, if any, with respect to the Controlled stock will be included in income immediately before the Distribution. (See Reg. §1.1502-19).
- (p) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (q) The Distribution will not constitute a disqualified distribution within the meaning of section 355(d). For purposes of Section 355(d), immediately after the Distribution, no person will hold stock (under section 355(d)(3)), in Distributing or Controlled, possessing 50 percent or more of the total combined voting power of all classes of Distributing or Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing or Controlled stock.
- (r) Neither Distributing nor Controlled has been (or will be) a United States real property holding corporation (as defined in Section 897(c)(2)) at any

PLR-161885-02

- (s) time during the 5-year period ending on the date of the Distribution, and neither of them will be a United States real property holding corporation immediately after the Distribution.
- (t) Distributing, Controlled and their shareholders will each pay their own expenses incurred in connection with the proposed transactions above.
- (u) 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 has acquired or 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 entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.
- (v) The proposed transactions, described above, are part of a single overall plan to distribute the stock of Controlled to Distributing's shareholders.
- (w) Neither Distributing nor Controlled is, plans to become, or will become eligible to become, an S corporation, real estate investment trust, insurance company, bank, savings and loan, controlled foreign corporation, or other corporation with a special tax status.

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

- (a) The transfer of assets by Distributing to Controlled followed by the Distribution will be a reorganization within the meaning of 368(a)(1)(D). Distributing and Controlled will each be a "party to a reorganization" within the meaning of section 368(b).
- (b) No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for Controlled stock and the assumption of liabilities by Controlled under sections 361(a) and 357(a).
- (c) No gain or loss will be recognized by Controlled on the receipt of Distributing assets in exchange for Controlled stock under section 1032(a).
- (d) The basis of each asset received by Controlled will be the same as the basis of such asset in the hands of Distributing immediately prior to the transfer under section 362(b).

PLR-161885-02

- (e) The holding period of the assets received by Controlled will include the period during which such assets were held by Distributing under section 1223(2).
- (f) No gain or loss will be recognized by Distributing under section 361(c)(1) upon the distribution to its shareholders of Controlled stock in the Distribution.
- (g) No gain or loss will be recognized by and no amount will be included in the income of Distributing's shareholders upon the receipt of Controlled stock from Distributing pursuant to the Distribution. 355(a)(1).
- (h) The aggregate basis of the Distributing stock and the Controlled stock in the hands of Distributing's shareholders after the Distribution will be the same as the aggregate basis of the Distributing stock in the hands of Distributing's shareholders immediately before the Distribution, allocated between the Distributing stock and the Controlled stock in proportion to the fair market values of each in accordance with Reg. §1.358-2(a)(2).
- (i) The holding period of the Controlled stock to be received by the Distributing shareholders will include the holding period of their Distributing stock, provided that the Distributing stock is held as a capital asset on the Distribution Date. Section 1223(1).
- (j) Earnings and profits will be allocated between Distributing and Controlled in accordance with Section 312(h) and Reg. §1.312-10(a).

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.

We express no opinion about the tax treatment of the transaction under any other section of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered in the above rulings.

PLR-161885-02

This ruling is directed only to the taxpayers that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, the original of this letter is being sent to the taxpayer's authorized representative.

A copy of this ruling letter should be attached to the federal income tax return of each taxpayer involved for the taxable year in which the transaction is consummated.

Sincerely yours,

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Alfred C. Bishop Jr.
Branch Chief, Branch 6
Office of Associate Chief Counsel
(Corporate)

cc: