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Department of the Treasury

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CC:CORP:B02 – PLR-152829-02

Date:

September 30, 2003

Distributing =

Controlled =

Partnership =

Corp A =

Corp B =

Corp C =

Business or
Business X =

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Country =

Region A =

Region B =

Region C =

Region C Assets =

a =b =c =z =

Dear

This is in response to a letter dated September 24, 2002, supplemented by additional submissions, requesting, on behalf of Distributing, rulings under Internal Revenue Code §§ 355, 368, 721, and related provisions, with respect to a series of proposed transactions.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalties 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. The material information submitted is summarized below.

Distributing is a domestic non-stock membership corporation and the common parent of an affiliated group of corporations that file consolidated Federal income tax returns. Distributing is principally engaged in the operation of Business X.

As a non-stock corporation, Distributing is owned by its members. Distributing has approximately a direct and indirect members. Inherent in a direct member's membership in Distributing is a non-exclusive, non-transferable license to use Distributing's name and trademarks in connection with the member's participation in

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Business X (the “Non-Equity Membership Rights”). The rights of the members to use Distributing’s name and trademarks are also set forth, generally, in individual license agreements between Distributing and each of the members.

A member’s equity rights (“Equity Interest”), the right to vote, right to earnings and profits and liquidation proceeds, if any, are set forth in Distributing’s bylaws. A member’s right to vote, right to earnings and profits and liquidation proceeds are determined according to formulas which are based on the relative amounts of business the member conducted in Business X.

Distributing’s members are organized by geographic regions. Each region develops and administers Distributing’s Business X within its geographic area. There are presently b regions, two of which, Region A and Region B, have consolidated their membership interest into corporate form (Corp A and Corp B). As such, Corp A and Corp B are classified as Regional Group Members of Distributing. The remaining regions act as divisions of Distributing. Members within each region elect a regional board which supervises the development and administration of Business X within the region.

Distributing’s principal source of gross income is fees paid by its members for services provided in connection with transactions involving Business X. These transaction fees are set and collected by the regions from the members located in the region. Each region sets fees to cover the costs of operating the region and the fees owed by the region to Distributing’s corporate headquarters. A portion of the fees collected are used to pay for the services provided by Zs. A subsidiary of Corp A, Corp C, operates c of the Zs. The remaining Zs are currently operated by Distributing or a subsidiary of Distributing. In addition to the other fees, initial fees are generally collected within each region from new members when they are admitted as members.

Distributing conducts its business on a cost basis. Thus, for example, fees paid by Distributing’s regions to Distributing’s corporate headquarters are intended to cover but not exceed Distributing’s corporate headquarters costs, including capital and reserve requirements. Financial information has been received indicating that Distributing’s operation of Business X had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing and its members located in Region C, the Region C Members, have determined that the operation of Business X in Region C would be enhanced by giving greater autonomy and control over the Region C operations of Business X to the Region C Members. Distributing and the Region C Members believe that this can be accomplished by creating for the Region C Members a Regional Group Member structure similar to the structure employed by Region A and Region B. The creation of

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Partnership and Controlled, in the structure described below, is intended to provide the Region C Members increased control over the portion of Business X within Region C.

The following transactions are therefore proposed:

1. The bylaws of Distributing will be amended to convert all the Distributing memberships temporarily into two classes. The Region C Members will become Class B Members, and the remaining members of Distributing will become Class A Members.
2. On behalf of all the Region C Members, one of the Region C Members will form Partnership as a Country private limited company and will subscribe for a single subscriber share. From its inception, Partnership will be classified as a partnership for Federal tax purposes.
3. An employee of Distributing will form Controlled as a corporation with a single subscriber share, held for the benefit of a third party to be designated by Distributing. Controlled will be organized as a domestic corporation that will operate in Country.
4. Distributing and Controlled will enter into the "Business Transfer Agreement" under which Distributing will transfer to Controlled a portion of Distributing's Business X that relates to the Business X operation in Region C ("The Region C Assets"). In consideration therefor, and at the direction of Distributing, Controlled agrees to issue shares of Controlled stock to Partnership and assume the Region C liabilities. At such time, the subscriber share in Controlled (issued in Step 3) will be cancelled.
5. The Region C Members' direct memberships in Distributing will be cancelled. Any Distributing dividends or distributions of assets on dissolution of Distributing will pass to Partnership (as Regional Group Member), and will be passed on to members of Partnership in the same manner had such members remained members of Distributing.
6. The Region C Members will be admitted as members of Partnership with their respective interests in Partnership reflecting their relative Equity Interests in Distributing immediately before the proposed transactions.
7. The Distributing trademark license granted to each Region C Member by Distributing will continue in full force and effect so long as the Region C Member remains a member of Partnership.

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8. Distributing and Controlled will enter into a “Distributing/Controlled Services Agreement,” under which Controlled will provide certain services in Region C to Partnership and the Region C Members as described in Schedule A of the agreement. Controlled will also provide certain services to Distributing or any of its members (other than the Region C Members) as set out in Schedule B of the agreement.
9. Distributing and Partnership will enter into the “Distributing/Partnership Group Member Agreement,” under which Partnership will be admitted as a Regional Group Member of Distributing with all the rights and obligations described in Distributing’s bylaws. Partnership’s Equity Interest in Distributing will be equal to the aggregate of the Region C Members’ Equity Interests in Distributing immediately before the proposed transactions, reduced to take into account the issuance of the Controlled stock.

Distributing’s bylaws provide that a Regional Group Member acquires all of the rights and privileges of certain categories of members within its region, for the purpose of sublicensing such rights and privileges to its owners and/or members. They also authorize a Regional Group Member to establish policies and promulgate rules and regulations regarding the administration, operation and development of Distributing’s programs within its region, which are consistent with Distributing’s bylaws, and acquire the right to vote at Distributing’s meetings and be represented on its Board of Directors. They also provide the Regional Group Member the right to share in any dividends or, in the event of Distributing’s liquidation, liquidating distributions.

Under the Distributing/Partnership Group Member Agreement, Partnership is required to pay or procure the payments of the Regional Group Member fees to Distributing, as determined by Distributing’s bylaws and carry out certain services (“Region C Membership Services”) relating to the portion of Distributing’s Business X carried out in Region C. Under this agreement, Partnership confirms that it is also subject to the terms and conditions of the “Distributing/Controlled Services Agreement” and that it will obtain from Controlled certain services (as defined in Schedule A of that services agreement) relating to Business X in the Region C for the Region C Members and Partnership shall pay, or procure the payment of, the compensation therein provided to be paid by it to Controlled.

10. Partnership and Controlled will enter into the Partnership/Controlled Services Agreement. Under this agreement, Partnership confirms that it

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will obtain certain services from Controlled that relate to the portion of Distributing's Business X carried out in Region C. Under the Partnership/Controlled Services Agreement, Partnership appoints Controlled as its agent to provide the Region C Membership Services to the Region C Members on its behalf. In consideration for providing the Region C Membership Services, Partnership shall pay or procure the payment to Controlled of initial membership fees paid by new members joining Partnership after the completion of the transaction that is the subject of this ruling request. Moreover, under the terms of the Partnership/Controlled Services Agreement, Controlled will collect membership fees from the Region C Members on behalf of Partnership, and pay a certain portion of the fees to Partnership, as required. Under the Partnership/Controlled Services Agreement, Partnership authorizes Controlled to use the Distributing name, any other Distributing mark, and any other rights, which Partnership, as a Regional Group Member is entitled to use during the term of the Partnership/Controlled Services Agreement, but only to the extent necessary for Controlled, as its agent, to provide the Region C Membership Services under the Partnership/Controlled Services Agreement.

Steps 1, 2 and 3 will take place before the other steps. All the other steps will take place thereafter and simultaneously.

Transfer of legal title to certain non-core Business X contracts (the "Delayed Assignment Contracts") may be delayed pending receipt of consents from unrelated parties. As soon as Distributing obtains the consents necessary to do so, Distributing will assign the Delayed Assignment Contracts to Controlled. While awaiting transfer, Distributing will hold the benefit of the Delayed Assignment Contracts in trust for Controlled.

Distributing has made the following representations with respect to the proposed transactions:

- (a) The fair market value of the Controlled stock and any other consideration received by each Region C Member will be approximately equal to the amount of the Region C Member's equity portion of its membership Interest in Distributing (liquidation rights) foregone by such Region C Member in exchange therefor.
- (b) No part of the stock of Controlled to be distributed by Distributing will be received by a shareholder of Distributing 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 is representative of Distributing's present operations, and there have been no substantial operational changes since the date of the last financial statements submitted, other than as described herein.
- (d) The five years of financial information submitted on behalf of Controlled is representative of the present operations of its active business, and with regard to its active business, there have been no substantial operational changes since the date of the last financial statements submitted, other than as described herein.
- (e) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior to the consummation of the transactions.
- (f) The distribution of the stock, or stock and securities, of Controlled is carried out for the following corporate business purpose: to enhance the performance of the businesses of Distributing and Controlled by resolving problems that arise, or are exacerbated, by the operation of Business X in Region C by enabling more focused management attention to the particular characteristics and needs of the Region C Business X operations. The distribution of the stock, or stock and securities, of Controlled is motivated in whole or substantial part, by this business purpose.
- (g) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the transaction other than the Region C Members' deemed contributions of their Controlled stock to Partnership.
- (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 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 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 transaction, except in the ordinary course of business.

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- (j) The total adjusted basis and fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled. The liabilities assumed in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the stock of Controlled other than that arising in the ordinary course of business or potentially pursuant to certain agreements between Distributing and Controlled.
- (l) 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 Treas. Reg. § 1.1502-13 and Treas. Reg. § 1.1502-14, as in effect before the publication of T.D. 8597, 1995-2 C.B. 147 and as currently in effect; Treas. 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 Treas. Reg. § 1.1502-19).
- (m) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be on the same terms as are applicable to other "Group Members" and Regional Group Members.
- (n) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (o) The distribution of the stock of Controlled 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 Equity Interests possessing 50% or more of the total combined voting power of all classes of Equity Interests in Distributing or stock possessing 50% or more of the total combined voting power of all classes of stock of Controlled, or Equity Interests possessing 50% or more of the total value of all classes of Equity Interests in Distributing or stock possessing 50% or more of the total value of all classes of stock of Controlled, except that, in the proposed transactions, Partnership directly, and the members of Partnership indirectly, will acquire stock possessing 50% or more of the voting power and value of Controlled.

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- (p) Neither Distributing nor Controlled was or will be a “United States real property holding corporation,” as defined in section 897(c)(2), at any time during the 5-year period ending on the date of distribution of Controlled or immediately after the distribution.
- (q) Partnership has no plan or intention to change its classification as a partnership for Federal income tax purposes, by election or otherwise.
- (r) Partnership will not be a publicly traded partnership within the meaning of section 7704.
- (s) Partnership would not be treated as an investment company (within the meaning of section 351(e)) if it were incorporated.
- (t) The Region C Members will not receive any portion of their Interests in Partnership for services or in exchange for any creditor’s interest in Distributing or for the assumption of any liability of Distributing.
- (u) To the best knowledge of Distributing and Partnership, there is no plan or intention on the part of any of the Region C Members to sell or otherwise dispose of its Interest in Partnership to be received in the proposed transactions. For purposes of this representation, neither the periodic changes in the relative Interests in Partnership held by the Region C Members as a result of the formulas for determining relative Interests nor the admission of new Region C Members to Partnership are considered sales or other dispositions of Interests.
- (v) There is no plan or intention on the part of Distributing to change significantly any of the formulas by which the relative Equity Interests in Distributing held by the members of Distributing are determined and periodically adjusted.
- (w) There is no plan or intention on the part of Partnership to change significantly any of the formulas by which the relative Interests in Partnership held by the Region C Members are determined and periodically adjusted. Such formulas will continue to correspond substantially to the formulas by which the relative Equity Interests in Distributing held by the Members of Distributing are determined and periodically adjusted.
- (x) There is no plan or intention on the part of Distributing, Partnership, or (to the best knowledge of Distributing) any of the Region C Members, to

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change substantially the Non-Equity Membership Rights of the Region C Members in connection with the operation of the Business, except to the extent necessary to interpose Partnership as an intermediate entity between the Region C Members and Distributing as set forth in this letter and to accomplish the business purposes set forth in this letter.

Based solely on the information submitted and the representations made, we rule as follows:

- (1) The temporary reclassification of the memberships in Distributing as Class A and Class B Memberships, the issuance and cancellation of the subscriber share in Controlled and the issuance of the subscriber share in Partnership will be disregarded.
- (2) The proposed transactions will be treated as though:
 - (a) Distributing had transferred the Region C Assets to Controlled in exchange for Controlled's assumption of the Region C liabilities and all of Controlled's stock (other than the subscriber share ignored in ruling (1) above).
 - (b) Distributing had distributed its Controlled Stock to its Region C Members in exchange for a portion of the Region C Members' Equity in Distributing.
 - (c) Each Region C Member had transferred its Controlled Stock and its remaining Equity in Distributing to Partnership in exchange for an Interest in Partnership.
 - (d) Each Region C Member retained its trademark license with Distributing which will continue in effect by virtue of the Region C Member's membership in Partnership.
- (3) The transfer by Distributing to Controlled of the Region C Assets solely for the deemed issuance of the stock of Controlled to Distributing and the assumption by Controlled of the Region C liabilities, together with the deemed distribution of the stock of Controlled to the Region C Members and the surrender of a portion of their Equity Interests in Distributing, will constitute a reorganization within the meaning of I.R.C. § 368(a)(1)(D). Distributing and Controlled will each be a party to a reorganization within the meaning of I.R.C. § 368(b).

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- (4) No gain or loss will be recognized to Distributing on the transfer of the Region C Assets to Controlled for the assumption by Controlled of the Region C liabilities and the deemed issuance of the stock of Controlled to Distributing. I.R.C. §§ 361(a) and 357(a).
- (5) No gain or loss will be recognized to Controlled upon its receipt of the Region C Assets solely for the assumption by Controlled of the Region C liabilities and the deemed issuance of the stock of Controlled to Distributing. I.R.C. § 1032(a).
- (6) The basis of the Region C Assets received by Controlled from Distributing will be the same as the basis of such assets in the hands of Distributing immediately prior to the transfer. I.R.C. § 362(b).
- (7) The holding period of the Region C Assets received by Controlled from Distributing will include the period during which Distributing held such assets. I.R.C. § 1223(2).
- (8) No gain or loss will be recognized to Distributing upon its deemed distribution of the stock of Controlled to the Region C Members and their deemed surrender of a portion of their Equity Interests in Distributing. I.R.C. § 361(c).
- (9) The deemed transfers to Partnership by the Region C Members of their Controlled stock and their Equity Interests in Distributing for Interests in Partnership, will not constitute a “purchase” by Partnership of any Controlled stock or any Equity Interest in Distributing, within the meaning of I.R.C. § 355(d)(5).
- (10) I.R.C. § 355(e) will not apply to the deemed distribution of the stock of Controlled to the Region C Members, notwithstanding the deemed transfers by the Region C Members of such stock and their Equity Interests in Distributing to Partnership.
- (11) As provided in I.R.C. § 312(h), the earnings and profits of Distributing will be allocated between Distributing and Controlled under Treas. Reg. § 1.312-10(a). I.R.C. § 312(h).
- (12) No gain or loss will be recognized to (and no amount will be included in the income of) the Region C Members upon their deemed receipt of the stock of Controlled. I.R.C. § 355(a).

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- (13) The Region C Members' basis in their Equity Interests in Distributing will be allocated, in each case, between such Equity Interest and the stock of Controlled, in proportion with relative fair market values. I.R.C. § 358(a), (b)(2) and (c). Generally, the Member's basis in their Equity Interests in Distributing is zero. Rev. Rul. 71-233, 1971-1 C.B. 113; see Rev. Rul. 74-277, 1974-1 C.B. 88.
- (14) The holding period of the stock of Controlled deemed to be received by each of the Region C Members will include the period during which such Region C Member held its Equity Interest in Distributing. I.R.C. § 1223(1).
- (15) No amount will be included in the income of the Class A Members of Distributing upon the deemed distribution to the Region C Members of the stock of Controlled. I.R.C. § 305(a) and (c).
- (16) Distributing's transfer of the Delayed Assignment Contracts to Controlled will occur pursuant to the plan of reorganization that includes Distributing's transfer of the other Region C Assets to Controlled and the deemed distribution of the Controlled stock by Distributing to the Region C Members. Treas. Reg. § 1.368-2(g).
- (17) No gain or loss will be recognized to (and no amount will be included in the income of) the Region C Members or Partnership on the deemed transfers by the Region C Members of their Controlled stock and their Equity Interests in Distributing to Partnership for Interests in Partnership. I.R.C. § 721(a).
- (18) Partnership's basis in the Controlled stock and in its Equity Interest in Distributing will be equal to the sum of the bases of the Region C Members in their Controlled stock and their Equity Interests in Distributing, respectively, immediately before the deemed transfers by the Region C Members to Partnership of such Controlled stock and Equity Interests. I.R.C. § 723.
- (19) Partnership's holding period in the Controlled stock and its Equity Interest in Distributing will include the Region C Members' holding periods with respect to their Controlled stock and their Equity Interests in Distributing, respectively. I.R.C. § 1223(2).
- (20) The basis of each of the Region C Members in its Interest in Partnership will be equal to the sum of its basis in its Controlled stock and its basis in its Equity Interest in Distributing immediately before the deemed transfer

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by such Region C Member of its Controlled stock and its Equity Interest in Distributing to Partnership. I.R.C. § 722.

- (21) The holding period of each of the Region C Members in its Interest in Partnership will include its holding period with respect to its Controlled stock and its Equity Interest in Distributing. I.R.C. § 1223(1).
- (22) No gain or loss will be realized by (and no amount will be included in the income of), the Region C Members, on the cancellation of the Region C Members' right to conduct Business X through their non-equity rights in Distributing and the Partnership's grant of equivalent non-equity rights to conduct Business X by virtue of the Region C Members' membership in Partnership. I.R.C. §§ 61(a) and 1001. The grant of rights to conduct Business X is not part of the transaction described in ruling (17) above.

No opinion is expressed as to the tax treatment of the transactions under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above ruling. Specifically, no opinion is expressed regarding the application of I.R.C. § 482 to the ongoing operations, including the application of I.R.C. § 482 to the Regional Group Member Agreement, the Distributing/Controlled Services Agreement and the Partnership/Controlled Services Agreement.

This ruling is directed only to the taxpayer(s) requesting it. I.R.C. § 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.

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

Sincerely,

Marlene P. Oppenheim
Senior Counsel
Office of Associate Chief Counsel
(Corporate)

cc: