

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200422003**

Release Date: 5/28/04

Index Number: 311.01-00; 312.00-00;
338.00-00; 355.01-00;
357.00-00; 358.00-00;
361.00-00; 362.00-00;
1502.13-00

Person To Contact: _____, ID No

Telephone Number:

Refer Reply To:
CC:CORP:B06 – PLR-147943-03
Date:
February 13, 2004

LEGEND

Distributing =
Controlled =
Corporation A =
Sub AA =
Sub BB =
LLC aa =
LLC bb =
LLC cc =
LLC dd =
State W =
State X =
State Y =
State Z =
Product xx =
Product yy =
Facilities =
Active Business =
Newco's Assets =

Controlled Assets =

Active Business
Assets of Controlled =

PLR-147943-03

Date 1 = =
Date 2 = =
Business Segment A = =
a = =
b = =
c = =
d = =
e = =
f = =
g = =
h = =
i = =
j = =
k = =
l = =
m = =

Dear

This is in reply to letters dated August 8, 2003, December 17, 2003, January 29, 2004, and February 4 and February 10, 2004 and February 13, 2004, requesting rulings concerning the federal income tax consequences of a proposed series of transactions culminating in *Distributing's* pro rata distribution of all of the outstanding stock of newly formed *Controlled*. The information submitted for consideration is summarized below.

Summary of Facts

Distributing (also referred to herein as the Taxpayer) is a publicly-held corporation incorporated in *State W* on *Date 1*. *Distributing* is also the common parent of an affiliated group ("Distributing Group") that files consolidated federal income tax returns. *Distributing* uses a calendar year as its taxable year and maintains its books and files its federal income tax returns on an accrual basis. As of *Date 2*, *Distributing* has issued and outstanding approximately *a* shares of common stock ("Distributing Stock") held by more than *b* shareholders and *c* shares of preferred stock ("Preferred Stock").

The Distributing Group is an integrated provider of *Product xx* and *Product yy* throughout the United States and abroad. The Distributing Group provides these and other services through *d* business segments. Specifically, *Distributing* has determined that *Business Segment A*, which involves both (i) the development, operation and management of *Facilities* and (ii) selling commodities and providing services relating to *Product xx* and *Product yy*, should be separated from the other business segments and spun off pro rata to the holders of Distributing Stock. Presently, the domestic assets

PLR-147943-03

comprising *Business Segment A* are held by *LLC aa*, *LLC bb*, *LLC cc* and *Sub AA*. ("LLC" means limited liability company).

The Distributing Group engages in the development, operation and management of *Facilities* primarily through *LLC aa*. The Distributing Group engages in selling commodities and providing services relating to *Product xx* and *Product yy* primarily through *LLC bb*.

LLC aa currently owns and manages *e* operating and *f* currently non-operating *Facilities*, although *LLC aa* is currently negotiating the sale of *m* operating *Facilities*. *LLC aa* is a *State X* limited liability company, wholly owned by *Sub AA*, and is disregarded as separate from its owner. *Sub AA* is a *State Y* corporation and a subsidiary of *Distributing* several tiers removed from *Distributing* in one of *Distributing's* chains of subsidiary corporations ("Sub chain 1").

Sub AA owns several subsidiary LLCs, each of which is disregarded for federal tax purposes. Unrelated third-party investors ("Investors") have lent approximately \$*i* million (the "Debt") to one of such subsidiaries, *LLC dd*: the Debt amount was loaned by *LLC dd* to other LLCs of *Sub AA*. Because all of these subsidiary LLCs are owned directly or indirectly by *Sub AA* and are disregarded for federal tax purposes, the Debt is treated as an obligation of *Sub AA* for federal tax purposes.

The Debt was incurred to finance *LLC aa's* acquisition of several *Facilities*. It is secured by liens on the *Facilities* and is also guaranteed by a first-tier subsidiary of *Distributing*. The Investors will not release the liens or such guarantee; therefore *Sub AA* must retire the Debt prior to the proposed spin-off. If the Debt is not retired, *Distributing's* first-tier subsidiary would be the guarantor of the debt of an unrelated corporation following the spin-off.

LLC bb is a *State X* limited liability company that is treated as a partnership for federal tax purposes. *Sub BB*, a member of the Distributing Group, owns *g%* of the membership interests in *LLC bb*, the other *h%* is owned by an affiliate of *Corporation A*. *Sub BB* is a *State Z* corporation and a subsidiary of *Distributing* several tiers removed from *Distributing* in Sub chain 2. It is a sister corporation to *Sub AA*.

Distributing and *Corporation A* are negotiating with respect to *Corporation A's* interest in *LLC bb*, and (i) *Sub BB* will acquire *Corporation A's* partnership interest in *LLC bb*, (ii) *LLC bb* will be liquidated and its assets distributed pro rata to *Sub BB* and *Corporation A*, or (iii) *Sub BB* will not acquire *Corporation A's* interest in *LLC bb* and *LLC bb* will not be liquidated. *Sub BB's* interest in *LLC bb*, whether comprising *g%* or 100% of the interest(s) in *LLC bb* or *g%* of the assets of *LLC bb*, is hereinafter referred to as the "*LLC bb* interests."

PLR-147943-03

In order to implement the spin-off, the following transactions are proposed:

1. *Sub AA* will transfer to *LLC aa* all of the membership interests in *LLC cc*, which is an entity wholly-owned by *Sub AA* and is disregarded as separate from its owner.
2. *LLC aa* will form a new *State X* corporation ("Newco") and will transfer all of its domestic assets other than membership interests in *LLC cc* and several of its subsidiary LLCs and other than the *m Facilities* currently the subject of sales negotiations, to Newco in exchange for (1) all of the outstanding common stock of Newco ("Newco Common Stock"), (2) \$*j* million par value, nonvoting, convertible, preferred stock of Newco ("Newco Preferred Stock"), and (3) one or more Newco notes in the aggregate principal amount of up to \$*k* million (the "Newco Note"). Moreover, a foreign subsidiary of *Distributing* may sell a *Facility* to Newco.
3. Prior to the formation of Newco, *LLC aa* or *Sub AA* will have entered into a binding agreement with the Investors to sell to the Investors all of the Newco Preferred Stock for approximately \$*j* million in cash. This cash, together with the amount to be obtained upon *LLC aa*'s disposition of the Newco Note, will be used by *Sub AA* to enable *Sub AA* to retire up to \$*i* million of the Debt.
4. *Sub AA* will distribute to its immediate parent all of its membership interests in *LLC aa* (exclusive of the *m Facilities* currently the subject of sales negotiations), which interests will continue to be distributed all the way up to *Distributing*.
5. *Sub BB*, a sister corporation to *Sub AA*, will distribute to its immediate parent the *LLC bb* interests, which will continue to be distributed all the way up to *Distributing*.
6. *Distributing* will contribute the *LLC bb* interests to *LLC aa*.
7. *LLC aa* will convert from a *State X* limited liability company to a *State X* corporation under the laws of *State X*, and all the membership interests in *LLC aa* will be converted into approximately *a* shares of common stock. (Pursuant to such conversion, *LLC aa* will then be referred to in this letter as "*Controlled*" and its common stock as "*Controlled Stock*").
8. *Distributing* will distribute all of the *Controlled Stock* to the holders of *Distributing Stock*, on the basis of one share of *Controlled Stock* for each outstanding share of *Distributing Stock* (the "*Distribution*").

PLR-147943-03

Distributing will treat the conversion of *LLC aa* from a *State X* LLC to a *State X* corporation as a contribution by *Distributing* of all of the assets of *LLC aa* (other than the *m Facilities* currently the subject of sales negotiations) to a new corporation controlled by *Distributing* as occurring in connection with a reorganization pursuant to section 368(a)(1)(D) of the Code. Before the Distribution, *Distributing* will not modify its ownership of the Controlled Stock.

The Distribution will enable the Distributing Group to effect a reduction in federal taxes inasmuch as the Distributing Group will recognize a loss to the extent that the federal income tax basis exceeds the current fair market value of the assets transferred to *Controlled*, which loss is estimated to be approximately \$1 million. Taxpayer has indicated that the Distribution would be consummated regardless of whether or not the Distributing Group would recognize a loss by reason of the Distribution.

Representations

Taxpayer makes the following representations:

1. Any indebtedness owed by *Controlled* to *Distributing* after the Distribution or evidenced by the Newco Note will not constitute stock or securities.
2. 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.
3. The five years of financial information submitted on behalf of *Distributing* is representative of each corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements, submitted.
4. The five years of financial information submitted on behalf of the *Active Business of Controlled* being transferred to *Controlled* is representative of its present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements, submitted.
5. Following the transaction, *Distributing* and *Controlled* will each continue the active conduct of its business, independently and with its separate employees.
6. The distribution of the stock of *Controlled* is carried out for the following Corporate Business Purposes, and the distribution of the stock of *Controlled* is

PLR-147943-03

motivated, in whole or substantial part, by one or more of these corporate business purposes:

- a) *Business Segment A* is no longer a "core" business of the Distributing Group and diminishes *Distributing's* ability to execute its revised strategy.
 - b) The greater business risk of *Business Segment A* potentially jeopardizes *Distributing's* continuing financial ability to pay a generous dividend to its shareholders consonant with its revised strategy.
 - c) The greater inherent business risk of Business Segment A necessitates significantly lower levels of debt as a standalone business and results in lower than optimal leverage at Distributing as currently combined.
 - d) *Business Segment A* is currently burdened with overhead costs from *Distributing* that results in a cost structure higher than is deemed appropriate for its type of business.
 - e) Operation as a standalone business with its own financial reporting and separately answerable to the capital markets will better support an ongoing restructuring of the *Business Segment A*. Separation is expected to improve information transparency and access to capital markets for both *Distributing* and *Controlled*, eventually resulting in lower overall capital costs for the two entities.
7. There is no plan or intention by any shareholder who owns 5% 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 of *Distributing*, to sell, exchange, transfer by gift, or otherwise dispose of any stock in either *Distributing* or *Controlled* after the transaction.
 8. There is no plan or intention by *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.
 9. There is no plan or intention to liquidate either *Distributing* or *Controlled*, to merge any of such corporations with any other corporation, or to sell or otherwise dispose of the assets of any of such corporations after the transaction, except in the ordinary course of business, or as a result of negotiations with *Corporation A* over the future of the *LLC bb* joint venture.

PLR-147943-03

10. One or more persons who, directly or indirectly, were the owners of *Distributing* prior to the Distribution will own, in the aggregate, 50% or more of the stock of each of *Distributing* and *Controlled* after the Distribution.
11. The Distribution will not be a disqualified distribution within the meaning of section 355(d)(2) of the Code because immediately after the Distribution (i) no person will hold disqualified stock in *Distributing* that constitutes a 50% or greater interest in *Distributing*, and (ii) no person will hold disqualified stock in *Controlled* that constitutes a 50% or greater interest in *Controlled*.
12. The Distribution is not part of a plan or series of related transactions (within the meaning of section 355(e) of the Code) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50% or more of the total combined voting power of all classes of stock of *Distributing* or *Controlled*, or stock possessing 50% or more of the total value of all classes of stock of *Distributing* or *Controlled*.
13. The total adjusted bases and the fair market value of the assets transferred to *Controlled* will each equal or exceed the sum of the liabilities assumed by *Controlled* plus any liabilities to which the transferred assets are subject; and 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.
14. *Distributing* neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
15. No intercorporate debt will exist between *Distributing* and *Controlled* at the time of, or subsequent to, the distribution of the Controlled Stock, except for possible indebtedness of *Controlled* to *Distributing* resulting from the limited and/or contingent credit support at arm's length pricing and terms that may be provided by *Distributing* to *Controlled*.
16. 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 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; Treas. Reg. § 1.1502-13 as published by T.D. 8597). Further, any excess loss account *Distributing* may have in the Controlled Stock (or in the stock of another corporation leaving the *Distributing* Group in the Distribution) will be included in income immediately before the Distribution to the extent required by applicable regulations. (See Treas. Reg. § 1.1502-19).

PLR-147943-03

17. Payments made in connection with all continuing transactions, if any, 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.
18. No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv) of the Code.
19. *Distributing* will not receive any money or property from *Controlled* in contemplation of the Distribution (other than in the ordinary course of business). However, *Sub AA* will receive the Newco Note from Newco in connection with the transfer of the *Newco Assets* to Newco.
20. Following the Distribution, there will be no continuing relationships between *Distributing* and *Controlled* such as common directors, officers or key employees, or commonly-owned property. Except for certain limited transition administrative functions, there will be no provision of goods and services to *Controlled* by *Distributing*. However, *Distributing* may provide limited credit support to *Controlled* and may retain certain pre-existing obligations.
21. Neither *Distributing* nor *Controlled* is, plans to become, will cease to be, or will become eligible to become a corporation with a special federal tax status.
22. With respect to (i) the transfer of the *Newco Assets* to Newco in exchange for Newco Common Stock, Newco Preferred Stock and the Newco Note, and (ii) the transfer of assets by *Distributing* to *Controlled* in exchange for *Controlled* Stock, neither transaction is an acquisition described in section 269(a)(1) or (a)(2) of the Code the principal purpose for which is evasion or avoidance of Federal income tax within the meaning of section 269(a) of the Code.
23. The Distribution is not engaged in or structured with a principal purpose to avoid the purposes of section 267 of the Code (including, for example, by avoiding treatment as an intercompany sale or by distorting the timing of losses or deductions), within the meaning of Treas. Reg. § 1.267(f)-1(h).
24. The gross assets of the trade or businesses relied on to satisfy the active business requirement of § 355(b) for both *Distributing* and *Controlled* will have a fair market value that is 5 percent or more of the total fair market value of the gross assets of the corporation directly conducting the trades or businesses.

Rulings

PLR-147943-03

Based solely on the information submitted by the Taxpayer, we rule as follows on the above described transactions:

1. *Sub AA* will recognize gain or loss on each of the *Newco Assets* that *LLC aa* transfers to *Newco* in an amount equal to the difference between (a) the fair market value of such asset and (b) the adjusted basis of such assets. Section 1001 of the Code; Treas. Reg. § 1.338-3(b)(3)(iv), Example 1; and Rev. Rul. 79-70, 1979-1 C.B. 144.
2. *Sub AA* will recognize gain or loss on each of the *Controlled Assets* that *LLC aa* holds when *Sub AA* distributes the *LLC aa* membership interests to its immediate parent in an amount equal to the difference between (a) the fair market value of such assets and (b) the adjusted basis of such assets. Sections 1001 and 311(b) of the Code; Treas. Reg. § 1.1502-13(f)(2)(iii).
3. Immediately prior to the Distribution, *Sub AA* will take into account the gain or loss on each of the *Newco Assets* that *LLC aa* transfers to *Newco* and each of the *Controlled Assets* that *LLC aa* holds when *Sub AA* distributes the *LLC aa* membership interests to its immediate parent. Treas. Reg. §§ 1.267(f)-1(c) and 1.1502-13(d).
4. *Sub BB* will recognize gain or loss on the transfer of its *LLC aa* interests to its immediate parent in an amount equal to the difference between (a) the fair market value of the *LLC aa* interests and (b) the adjusted basis of the *LLC aa* interests. Sections 1001 and 311(b) of the Code; Treas. Reg. § 1.1502-13(f)(2)(iii).
5. Immediately prior to the Distribution, *Sub BB* will take into account the gain or loss on the transfer of the *LLC aa* interests to its immediate parent. Treas. Reg. §§ 1.267(f)-1(c) and 1.1502-13(d).
6. The conversion of *LLC aa* from a *State X* limited liability company to a *State X* corporation will be treated as a contribution by *Distributing* of all of the *Controlled Assets* to *Controlled*, which contribution, followed by the distribution of the *Controlled Stock* by *Distributing* pro rata to the holders of *Distributing Stock*, will constitute a reorganization within the meaning of sections 368(a)(1)(D) and 355 of the Code. Accordingly:
 - a. No gain or loss will be recognized by *Distributing* upon the contribution of the *Controlled Assets* to *Controlled* in exchange for *Controlled Stock* and the assumption of liabilities. Sections 361(a) and 357(a) of the Code.

PLR-147943-03

- b. No gain or loss will be recognized by *Controlled* upon the receipt of the Controlled Assets in exchange for Controlled Stock and the assumption of liabilities. Section 1032(a) of the Code.
- c. *Controlled's* basis in each of the Controlled Assets will be equal to the basis of such asset in the hands of *Distributing* immediately prior to the deemed contribution of the Controlled Assets to *Controlled*. Section 362(b) of the Code.
- d. *Controlled's* holding period for each of the Controlled Assets will include (a) the period during which *Distributing* held such asset and (b) the periods during which *Sub AA* and *Sub BB* (and all corporations starting with the parent corporation of *Sub AA* up to *Distributing* and starting with the parent corporation of *Sub BB* up to *Distributing*) held such assets. Treas. Reg. § 1.1502-13(c)(1)(ii); Section 1223(2) of the Code.
- e. No gain or loss will be recognized by *Distributing* upon the distribution of Controlled Stock. Section 361(c) of the Code.
- f. No gain or loss will be recognized by the *Distributing* shareholders (and no amount will be included in the income of any of them) upon receipt of the Controlled Stock. Section 355(a)(1) of the Code.
- g. The aggregate basis of the Distributing Stock and the Controlled Stock held by each *Distributing* shareholder will equal the aggregate basis of each such shareholder's Distributing Stock immediately before the Distribution, allocated between the Distributing Stock and the Controlled Stock in proportion to the fair market value of each in accordance with Treas. Reg. section 1.358-2(a)(2). Section 358(a), (b) and (c) of the Code.
- h. The holding period of the Controlled Stock received by *Distributing's* shareholders will include the holding period of the Distributing Stock with respect to which the distribution is made, provided that such Distributing Stock is held as a capital asset on the date of the distribution. Section 1223(1) of the Code.
- i. Proper allocation of earnings and profits between *Distributing* and *Controlled* will be in accordance with Treas. Reg. sections 1.312-10(a) and 1.1502-33(e).

Caveats

PLR-147943-03

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 as to whether either (i) the transfer of the *Newco Assets* to Newco in exchange for Newco Common Stock, Newco Preferred Stock and the Newco Note, or (ii) the transfer of assets by Distributing to Controlled in exchange for Controlled Stock, constitutes an acquisition described in section 269(a)(1) or (a)(2) of the Code for which the principal purpose is evasion or avoidance of Federal income tax within the meaning of section 269(a) of the Code. Moreover, no opinion is expressed as to whether any of the proposed transactions is engaged in or structured with a principal purpose to avoid the purposes of I.R.C. § 267, including distorting the timing of losses or deductions.

Procedural Statements

This ruling is directed only to the Taxpayer (i.e., acting for its own behalf and as agent for all the current members of the Distributing Consolidated Group) requesting it. Section 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 representative.

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

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.

Sincerely,

Steven J. Hankin

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