

State A =
Year 1 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
a =
b =
c =
Intercompany Transaction =

Dear :

This letter responds to your request, dated June 4 2015, submitted by your authorized representatives on behalf of Parent, for a ruling on certain federal income tax consequences of a restructuring transaction (the "Transaction"). The information submitted in that request and in later correspondence is summarized below.

SUMMARY OF FACTS

Parent is a State A corporation publicly traded and the common parent of an affiliated group of includible corporations which join in the filing of a consolidated federal income tax return (the Parent Consolidated Group).

Holdco is a holding company organized on Date 1 under the laws of State A and has been a member of the Parent Consolidated Group since inception. Holdco was initially formed to acquire Sub 1. Since its inception, Holdco has had no separate business operation or assets aside from its stock in subsidiary corporations.

On Date 2, Holdco acquired Sub 1 (the Sub 1 Acquisition). Beginning of Date 2, Sub 1 filed as part of the Parent Consolidated Group.

On Date 3, Holdco acquired Sub 2 (the Sub 2 Acquisition). Sub 2 directly owned 100% of the issued and outstanding stock of Sub 3, which owned 100% of the issued and outstanding stock of Sub 4 and 100% of the membership interest in Sub 5, a limited liability company treated as a disregarded entity for federal income tax purposes. Sub 4 owned 100% of the issued and outstanding stock of Sub 6, which, in turn, owned 100% of the issued and outstanding stock of Sub 7. Beginning on Date 3, Sub 2, Sub 3, Sub 4 and Sub 5 filed as part of the Parent's Consolidated Group.

Subsequent to the Sub 2 Acquisition, production and quality issues were identified for both Sub 1 and Sub 2 resulting in lost customers and damage to the Sub 1 and Sub 2 brands. As a result, value declined significantly and projections were revised downward.

During all tax periods including and subsequent to Date 1, Holdco had no separate business operations or assets (including cash) aside from its stock in Sub 1 and Sub 2 and served solely as a holding company for these subsidiaries, which were engaged in certain businesses.

Immediately prior to the Restructuring, defined below, Holdco had both voting and non-voting common stock issued and outstanding. Additionally, Holdco had two classes of convertible preferred stock issued and outstanding. Series A convertible preferred stock and Series B convertible preferred stock. Immediately prior to the restructuring, Parent owned, in the aggregate, b of the vote and value of Holdco. The remaining c of the vote and value of Holdco was owned by Holdco's management (the Employees) who had rolled over interests as part of the Sub 1 and Sub 2 acquisitions.

In addition, immediately prior to the Restructuring, Sub 1, Sub 2, and Sub 3, as co-obligors, owed Parent a cumulative amount approximately equal to a with Holdco as a guarantor (The Intercompany Loan Agreements).

Because Holdco did not have separate cash account, certain expenses incurred by Holdco were paid directly by Sub 1 and Sub 3. Included in these expenses were the

amounts owed by Holdco to its managers/employees. The amounts owed by Holdco and paid by Sub 1 and Sub 3 were characterized and treated by Holdco as dividends paid. In each of these instances, the expenses were incurred by Holdco, Sub 1 or Sub 3 disbursed the necessary funds to Holdco's creditors in satisfaction of Holdco's liability.

Parent submitted financial information indicating that the businesses conducted by Sub 1, Sub 3, Sub 4, and Sub 5, each has had gross receipts and operating expenses representative of the active trade or business for each of the past five years.

Parent provided the following description of the transaction (Restructuring):

- (i) On Date 4, Holdco contributed the stock of Sub 1 to Sub 2 in exchange for no consideration.
- (ii) On Date 5, Holdco converted to a limited liability company pursuant to state law.
- (iii) On Date 6, Parent converted a portion of the debt owed by Holdco and its subsidiaries in exchange for newly issued membership interest of Holdco. Holdco then capitalized the debt to Sub 1, Sub 2, and Sub 3.

DISCUSSION

Section 165(g)(3) provides taxpayers that are domestic corporations with an ordinary loss on the worthlessness of stock in an affiliated subsidiary. Section 165(g)(3) sets forth two requirements a subsidiary must satisfy in order to be considered affiliated with the taxpayer. Paragraph (A) requires that stock meeting the requirements of section 1504(a)(2) be owned directly by the taxpayer. Paragraph (B) requires that more than 90 percent of the aggregate of the subsidiary's gross receipts for all taxable years be from sources other than the listed "passive sources" which are royalties, certain rents, dividends, interest (except interest received on deferred purchase price of operating assets sold), annuities, and gains from sales or exchanges of stocks and securities.

Rev. Rul. 88-65, 1988-2 C.B. 32, concludes that the rents received from short term vehicle leases are not rents for purposes of section 165(g)(3)(B) due to the significant services provided by the lessor. The ruling reasons that guidance interpreting similar statutory language in section 1244, regarding "section 1244 stock," and section 1362, regarding the passive income limitation of S corporations with C corporation earnings and profits, is relevant in construing section 165(g)(3)(B). Section 1.1362-2(c)(5)(ii)(A)(2) provides that royalties does not include royalties derived in the ordinary course of a trade or business of franchising or licensing property. Royalties received by a corporation are derived in the ordinary course of a trade or business of franchising or licensing property only if, based on all the facts and circumstances, the corporation -- (i) created the property; or (ii) performed significant services or incurred substantial costs with respect to the development or marketing of the property.

REPRESENTATIONS

- (i) Parent has owned more than 80% of the vote and value of Holdco within the meaning of section 1504(a)(2) since its formation on Date 1.
- (ii) Holdco's adjusted basis in its Sub 1 shares transferred to Sub 2 pursuant to the Sub 1 contribution were greater than the fair market value of such property
- (iii) The Intercompany Loan Agreements are debt instruments for U.S. federal income tax purposes.
- (iv) Immediately before the Restructuring, Holdco's stock was worthless within the meaning of section 165(g)(1) and Treas. Reg. §1.1502-80(c).
- (v) Sub 1 and Sub 3 have historically had greater than 90% of its gross receipts from active sources within the meaning of section 165(g)(3).
- (vi) Parent will claim a worthless stock loss with respect to the stock of Holdco only to the extent permitted by § 1.1502-36 relevant to the Sub 1 contributions and each loss transfer pursuant to the Holdco conversion.

RULINGS

Based solely on the information provided, we rule as follows:

For purposes of the section 165(g)(3)(B) gross receipts test, Holdco will include in its aggregate gross receipts all amounts of gross receipts received in intercompany transactions that are described in Treas. Reg. § 1.1502-13 (as effective/applicable on or after July 12, 1995) ("Intercompany Transactions"), and such amounts from Intercompany Transactions will be treated as "gross receipts from passive sources" only to the extent they are attributable to the Intercompany Transactions' counterparty's "gross receipts from passive sources" ("Look-Through Approach"). See Treas. Reg. 1.1502-13(a), (b), and (c) (as effective/applicable on or after July 12, 1995). For purposes of these rulings, "gross receipts from passive sources" is defined as royalties (other than the franchise fees described in ruling 5), certain rents, dividends (other than dividends received from affiliates), interest, annuities, and gains from sales of stock and securities as defined in section 165(g)(3) and the regulations thereunder.

CAVEATS

The rulings contained in this letter are based upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Except at otherwise provided herein, no opinion is expressed or implied regarding the appropriate adjustments to basis under section 1.1502-36(g) or the application of section 382 to any transaction or item referenced in this letter.

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, we express or imply no opinion whether the taxpayer otherwise meets the requirements of section 165.

PROCEDURAL STATEMENTS

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.

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. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Isaac W. Zimbalist
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Corporate)

cc: