

**Internal Revenue Service**

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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

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CC:CORP:B04  
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Date:  
September 04, 2019

Legend

Distributing =

State A =

Industry A =

Industry AA =

Step 1 =

Step 2 =

Step 2A =

Step 2B =

Step 2C =

Step 2C1 =

Step 2C2 =

Step 2D =

Step 3 =

Step 4 =

Products A =

Business 1 =

Business 2 =

Item A =

Item 1 =

Date A =

Year A =

Larger Scale =

Several  
Collaborators =

Collaborator A =

Collaborator  
Agreement =

Investment  
Banker =

a =

b =

Sub1 =

Dear \_\_\_\_\_ :

This letter responds to your letter dated February 1, 2018, requesting a ruling on certain federal income tax consequences of the Proposed Transaction, defined below. The information submitted in that letter and in subsequent correspondence is summarized below.

The ruling contained in this letter is 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 the ruling, it is subject to verification on examination.

This letter is issued pursuant to section 4 of Rev. Proc. 2017-52, 2017-41 I.R.B. 283, amplified and modified by Rev. Proc. 2018-53, 2018-43 I.R.B. 667, and section 6.03(2) of Rev. Proc. 2018-1, 2018-1 I.R.B. 1, regarding a significant issue under section 355 of the Internal Revenue Code. The ruling contained in this letter only addresses one significant issue involved in the Proposed Transaction. This office expresses no opinion as to the overall tax consequences of the Proposed Transaction or as to any issue not specifically addressed by the ruling below.

### **Summary of Facts**

Distributing, a State A corporation, is publicly traded and owns all the outstanding stock of Sub 1, its only subsidiary. Distributing is an Industry A company. Industry A companies seek to create Items A and are also considered to be Industry AA companies. Typically, for Items A to be commercialized they go through a four step process: Step 1, Step 2, Step 3, and Step 4. Each step is composed of subparts. Specifically, Step 2 is composed of four subparts: Step 2A, Step 2B, Step 2C, and Step 2D. Step 2C is composed of Step 2C1 and Step 2C2.

#### **Business 1 (Step 1 through Step 2C1)**

Distributing's historic business consists of the activities in Step 1 through Step 2C1 ("Business 1"). Distributing's Business 1 relies on its research and development to identify and create new Products A. Products A are then tested and modified to create Items A for later testing and ultimate commercialization. Over the years Distributing has created Items A and continues to create other Items A.

Prior to the commencement of Distributing's Business 2, described below, Steps 2C2 through 4 (the remaining steps to bring Items A to commercialization) were not a part of Distributing's business. Instead, for the Items A developed through Business 1, these steps were performed by third party Industry AA companies pursuant to license and collaboration agreements.

Item 1, a type of Item A, has progressed through Business 1 from Step 1 through Step 2C1. At Step 2C1, Item 1 has been tested in a variety of possible conditions and its development is typical of Distributing's Business 1 practice.

### Business 2 (Steps 2C2 through Step 3)

On Date A (more than five years before the date of the Proposed Transaction), Distributing began conducting research, development, testing, and regulatory functions for Item 1 developed in Business 1, through Step 2C1. Distributing intends that it will develop Item 1 from Step 2C2 through Step 3 ("Business 2"). Step 2D generally consists of duplicating tests performed in Step 2C2 but on a Larger Scale. Item 1 has not progressed beyond Step 2C2.

After Step 3 but before Step 4, Business 2 will partner or collaborate with one or more Industry AA partners that have the experience, knowledge, and a salesforce to move Item 1 efficiently through the next steps. However, despite a progression to Step 4, Step 3 activities will still need to be conducted and Business 2 will conduct those activities.

Since Date A, Distributing has allocated managerial and operational employee time to support Business 2 and has more recently devoted employees full time to Business 2. As a result, Distributing has incurred significant salary and wage expense in connection with Business 2.

### Business 1 Income

For more than five years, Business 1 consistently generated income through contractual relationships with Industry AA companies from research-oriented contracts or certain licensing. For example, Distributing received income from agreements with Several Collaborators and Collaborator A which are all Industry AA companies. In Year A, Distributing and Collaborator A entered into the Collaborator Agreement whereby Collaborator A received access to all of Distributing's Items A except Item 1. In exchange, Distributing received an upfront cash licensing fee and annual research and reimbursement of at least \$a per year for at least b years. The Items A that were part of the Collaborator Agreement consisted of Items A that were in Step 2C1 or earlier.

### Potential Income for Business 2

Even though Business 2 has never generated income, Distributing believes that Business 2 had the ability to generate income since Date A through licensing of certain rights to Item 1 or partnering with Industry AA companies. Distributing represents that, based on the Items A that were included in the Collaborator Agreement, it believes that it could have entered into a partnership or collaboration agreement with Collaborator A for the development and commercialization of Item 1 similar to the Collaborator Agreement, and that Item 1 has greater potential and value. Distributing also represents that it is easier to obtain income from Items A the further they have

progressed through the steps. Distributing submitted a list, provided to it by Investment Banker, of deals within the past five years, between parties unrelated to Distributing, involving licenses of other Items A in Step 2C with upfront cash payments by the licensee to the licensor. Distributing has stated that the listed Items A are similar and comparable to Item 1.

However, Distributing has decided to forego immediate collection of income from Business 2 in favor of the prospect of collecting significantly greater income after Step 3 is completed with respect to Item 1. As indicated above, after Step 3 but before Item 1 is commercialized, Business 2 intends to partner or collaborate with Industry AA partners that have the experience, knowledge, and a salesforce to move Item 1 efficiently through to the next steps. Business 2 will then generate income at this step through receipts of royalties, milestone payments, or profit-splits.

### **Proposed Transaction**

For what are represented to be valid corporate business purposes, Distributing proposes to engage in the following transaction to separate Business 1 from Business 2 (the "Proposed Transaction").

1. Distributing will form a State A corporation ("Controlled") and contribute Business 2 to Controlled in exchange for all of the stock of Controlled and the assumption by Controlled of all of Business 2's liabilities (the "Contribution").
2. Distributing will distribute all of the stock of Controlled pro rata to Distributing's shareholders (the "Distribution").

Following the Distribution, Distributing will continue to conduct Business 1, and Controlled will conduct Business 2.

### **Representations**

Distributing makes the following representations with respect to the Proposed Transaction:

1. Except for the issue of whether the absence of income collection prevents Distributing's Business 2 from constituting a "trade or business" within the meaning of Treas. Reg. § 1.355-3(b)(2)(ii), the Contribution and the Distribution will qualify as a transaction in which no gain or loss is recognized to Distributing, Controlled, or Distributing's shareholders, and no amount is included in the income of Distributing's shareholders, under section 368(a)(1)(D) and section 355.
2. Immediately after the Distribution, the fair market value of the gross assets of the trade or business in which each of Distributing and Controlled will rely to satisfy the active trade or business requirement of section 355(b) will be, in

- each case, at least 5 percent of the fair market value of the total gross assets of that corporation. For purposes of determining the fair market value of the total gross assets of Distributing and the gross assets of Business 1, Distributing and Sub 1 are treated as one corporation.
3. Immediately after the Distribution, the fair market value of the gross investment assets of each of Distributing and Controlled will be less than two-thirds of the fair market value of its total gross assets. For purposes of determining the fair market value of Distributing's and Controlled's gross investment assets and total gross assets: (i) Distributing and Sub 1 are treated as one corporation; (ii) the term "investment assets" has the meaning as defined in section 5.01(3) of Rev. Proc. 2018-3, 2018-1 I.R.B. 130; and (iii) no assets have been disposed of or acquired with a principal purpose of making this representation.

### **Ruling**

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

The absence of income collection does not prevent Distributing's Business 2 from constituting a "trade or business" within the meaning of Treas. Reg. § 1.355-3(b)(2)(ii) for purposes of determining whether the Distribution satisfies the active trade or business requirement of section 355.

### **Procedural Statements**

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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. 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 this letter.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

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Russell P. Subin  
Senior Counsel, Branch 3  
Office of Associate Chief Counsel (Corporate)

cc: