

Internal Revenue Service

Department of the Treasury

Index Numbers: 0355.00-00
0355.01-00

Washington, DC 20224

Number: **199909027**
Release Date: 3/5/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP:5 PLR-115637-98
Date:
December 2, 1998

Re:

Distributing =

Controlled =

Business A =

Business B =

Investment
Banker =

C =

D =

State E =

State F =

g =

h =

i =

j =

k =

Dear

We respond to your July 29, 1998, request for rulings as to the federal income tax consequences of a proposed transaction. You submitted additional information in letters dated October 6, November 13, and November 25, 1998. The information submitted for consideration is substantially as set forth below.

Distributing is a State E corporation and is the common parent of a consolidated group of corporations. Distributing has outstanding g shares of common stock. These shares are widely held and are publicly traded on a national stock exchange. To the taxpayer's knowledge, each of Distributing's current shareholders owns less than five percent of Distributing's outstanding common stock, except for D, which owns h percent of Distributing stock. Distributing also has three separate classes of convertible preferred stock. Only one class of preferred stock is currently outstanding, which is wholly held by C. It is anticipated that, as part of the transaction, C will convert its convertible preferred stock into Distributing common stock. In that case, C will own approximately k percent of Distributing stock.

Controlled is a state F corporation and is actively engaged in Business B. Distributing will own i percent of and will be in control of Controlled prior to the transaction.

Distributing has submitted data indicating that Business A and Business B each have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Distributing is actively engaged in Business A, and Controlled is actively engaged in Business B. Distributing and Controlled are in need of raising equity capital to continue to fund the growth of these businesses. Distributing believes, and has submitted independent financial documentation and analysis in support of its assertions, that the most efficient means of raising equity capital involves the distribution of at least 80 percent of Controlled shares to its shareholders, followed by an initial public offering of

Controlled common stock.

Distributing has been advised by Investment Banker that retaining approximately j percent of Controlled's common stock after the distribution will lower Distributing's cost of raising equity capital. Distributing intends to sell these retained shares of Controlled stock as part of Controlled's initial public offering or shortly thereafter, but in any event, no later than five years from the date of Distributing's distribution of Controlled stock. The taxpayer has provided sufficient information to substantiate that Distributing's retention of the shares of Controlled stock (1) will not prevent the distribution from constituting a genuine separation of the corporate entities, (2) will not enable Distributing to maintain practical control of Controlled, and (3) has sufficient business purposes (see Rev. Rul. 75-321, 1975-2 C.B. 123, and Appendix B of Rev. Proc. 96-30, 1996-1 C.B. 696).

Accordingly, the following transaction is proposed:

- (i) Distributing will distribute Controlled common stock representing 80 percent of the total voting power of all stock entitled to vote pro rata to its shareholders and will retain all shares in excess of the number of shares required to distribute 80 percent of the total voting power of Controlled, approximately j percent of the voting power of Controlled stock.
- (ii) As soon as practical, Controlled will undertake an initial public offering of newly issued Controlled common stock, after which the Distributing shareholders will continue to own stock representing more than 50 percent of the vote and value of Controlled.
- (iii) Distributing will sell all of the retained stock in the public offering or soon thereafter, market conditions permitting, but in any event, no later than five years after the distribution described in step (i).

The taxpayers have made the following representations in connection with the proposed transaction:

- (a) There is sufficient business purposes for Distributing's retention of approximately j percent of Controlled's common stock; none of the directors or officers of Distributing will serve as directors or officers of Controlled after the distribution as long as Distributing retains the Controlled stock; Distributing intends to sell the retained stock either in the initial public offering of Controlled common stock or shortly thereafter, but in any event, Distributing will sell all of the retained stock within five years of the distribution; and Distributing will vote the retained stock in proportion to the votes cast by Controlled's other shareholders.

- (b) No part of the consideration distributed by Distributing is being received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder.
- (c) The five years of financial information submitted on behalf of Distributing and Controlled is representative of each corporation's present operations, and with regard to such corporations, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, the Distributing and Controlled corporations each will continue the active conduct of its business, independently and with its separate employees, except, for a transition period, Distributing will provide certain services to Controlled.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purposes: Provide Distributing with a more efficient means of raising capital equity than other equity alternatives; Improve Distributing's ability to enter into strategic relationships with respect to its business; Improve Controlled's ability to fund its growth capital needs; Improve the potential to expand Controlled's business through the use of common stock as currency in acquisitions of potential target companies. The distribution of the stock of Controlled is motivated, in whole or substantial part, by these corporate business purposes.
- (f) The initial public offering of Controlled stock will be completed within one year of the distribution, market conditions permitting.
- (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 transaction.
- (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 subsequent to the

distribution, except in the ordinary course of business.

- (j) No property is being transferred between Distributing and Controlled nor is Controlled assuming any liabilities or receiving assets subject to liabilities.
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the stock in 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 § 1.1502-13 and § 1.1502-14 of the Income Tax Regulations as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and currently in effect; § 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account with respect to the Controlled stock will be included in income immediately before the distribution (See § 1.1502-19).
- (m) Payments made in connection with all continuing transactions between Distributing and Controlled, if any, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length. Pursuant to a services agreement, Distributing will provide certain services to Controlled for a transition period.
- (o) No two parties to the proposed transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

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

- (1) No gain or loss will be recognized by (and no amount will be included in the income of) Distributing's shareholders on receipt of the Controlled stock (§ 355(a)(1)).
- (2) No gain or loss will be recognized to Distributing upon the distribution of its Controlled stock (§ 355(c)(1) and 355(e)).
- (3) The holding period of the Controlled stock to be received by the Distributing shareholders will include the holding period of their Distributing stock, provided such stock is held as a capital asset on the date of the transaction (§ 1223(1)).
- (4) The basis of the stock of Controlled and Distributing in the hands of Distributing's shareholders after the distribution will be the same as the

basis of the Distributing stock held immediately before the distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(a)(1)).

- (5) As provided in § 312(h), following distribution of the Controlled stock, proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 1.312-10(b).
- (6) The retention by Distributing of approximately j percent of Controlled's common stock, as described above, will not be in pursuance of a plan having as one of its principal purposes the avoidance of federal income tax within the meaning of § 355(a)(1)(D)(ii).

We express no opinion about the tax treatment of the proposed transaction 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 completed transaction that are not specifically covered by the above rulings.

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

Each affected taxpayer must attach a copy of this letter to the federal income tax return for the taxable year in which the transaction covered by this letter ruling is consummated.

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

Sincerely yours,

Assistant Chief Counsel (Corporate)

By _____

Filiz A. Serbes

Assistant to the Chief, Branch 5