

Internal Revenue Service

Department of the Treasury

Index Numbers: 355.01-00, 368.04-00

Washington, DC 20224

Number: **200033029**
Release Date: 8/18/2000

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Telephone Number:

Refer Reply To:
CC:DOM:CORP:Br4 PLR-101763-00
Date:
May 18, 2000

Distributing	=
Controlled	=
Sub 1	=
Sub 2	=
Sub 3	=
Sub 4	=
Sub 5	=
Sub 6	=
Sub 7	=
Sub 8	=
Corp W	=
Corp X	=
Corp Y	=
Corp Z	=
Business A	=
Business B	=
Business C	=
Year 1	=

Year 2 =
Year 3 =
a =
b =
c =

This letter responds to your January 12, 2000 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that letter and in later correspondence is summarized below.

The rulings in this letter are based on 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 materials submitted in support of the ruling request. Verification of the facts, information, and other data in this ruling letter may be required as part of the audit process.

Summary of Facts

Distributing is a publicly traded holding company that conducts Business A, Business B, and Business C through its subsidiaries. Distributing wholly owns Sub 1 (Business A), Sub 2 (Business B), Sub 4 (Business C), Sub 5 (Business C), Sub 6 (Business C), Sub 7 (Business C), and Sub 8 (Business C). Sub 2 wholly owns Sub 3, which holds debt securities and other short-term investment assets.

Sub 1, Sub 2, Sub 4, Sub 5, and Sub 6 each has engaged in its business for more than five years. Sub 7 has engaged in Business C since Year 1, when it was formed by Distributing to purchase the Business C assets of Corp W ("Acquisition 1"). Sub 8 has engaged in Business C since Year 2, when it was formed by Distributing to purchase the Business C assets of Corp X ("Acquisition 2"). In addition, Distributing directly purchased the Business C assets of Corp Y ("Acquisition 3") and Corp Z ("Acquisition 4") in Year 3 (Acquisitions 1 through 4, collectively, the "Acquisitions").

Financial information has been received indicating that Business A (as conducted by Sub 1) and Business B (as conducted by Sub 2) each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing has issued, and expects to continue issuing, stock options as compensation to employees and directors (the "Compensatory Options"). Distributing is also authorized to repurchase shares of its stock under its stock repurchase plan.

Management of Distributing wishes to expand Business C by making acquisitions using Distributing stock as consideration. Distributing's financial advisor has concluded, in a series of reasoned and detailed letters, that Distributing's cost of making these acquisitions would be materially lower if Business C were separated from Business B.

Proposed Transaction

To accomplish this separation, Distributing has proposed the following series of steps (collectively, the "Proposed Transaction"):

- (i) Sub 1 will liquidate into Distributing in a transaction the taxpayer represents will qualify under § 332 of the Internal Revenue Code (the "Code" and the "Liquidation").
- (ii) Sub 2 will distribute its Sub 3 stock to Distributing ("Distribution 1").
- (iii) An a dollar intercompany payable owed by Distributing to Sub 2 will be canceled (the "Cancellation").
- (iv) Distributing will contribute its Sub 2 stock to newly formed Controlled in exchange for all of Controlled's stock (the "Contribution").
- (v) Distributing will distribute the Controlled stock pro rata to its shareholders ("Distribution 2"). Fractional shares of Controlled stock that would otherwise have been issued in Distribution 2 will be accumulated by the issuing agent and sold by a stock brokerage firm to the general public, with the net proceeds going to the shareholders who would have received the fractional shares.
- (vi) Within one year following Distribution 2, Distributing will use b percent of its stock to acquire companies that will augment its Business C operations.

Contribution and Distribution 2 Representations

The taxpayer has made the following representations regarding the Contribution and Distribution 2:

- (a) No part of the consideration distributed by Distributing will be received by a shareholder as a creditor, employee, or in any other capacity other than that of a shareholder of Distributing.
- (b) The five years of financial information submitted on behalf of Sub 1 (for Business A) and Sub 2 (for Business B) represents the present operations of each corporation, and there have been no substantial operational changes to either corporation since the date of the last submitted financial statements.

(c) Immediately after Distribution 2, the gross assets of the trade or business relied on by Distributing to satisfy the active trade or business requirement of § 355(b) (Business A) will have a fair market value equal to at least five percent of the total fair market value of Distributing's gross assets.

(d) Immediately after Distribution 2, the gross assets of the trade or business relied on by Controlled to satisfy the active trade or business requirement of § 355(b) (Business B of Sub 2) will have a fair market value equal to at least five percent of the total fair market value of Sub 2's gross assets.

(e) Immediately after Distribution 2, at least 90 percent of the fair market value of the gross assets of Controlled will consist of stock and securities of a controlled corporation (Sub 2) that is engaged in the active conduct of a trade or business as defined in § 355(b)(2).

(f) Following Distribution 2, Distributing and Sub 2 each will continue the active conduct of its business, independently and with its own employees, except for sharing c for a limited time.

(g) Distribution 2 is being carried out so that Distributing can make more efficient use of its stock in expanding Business C. Distribution 2 is motivated, in whole or substantial part, by this corporate business purpose and other business reasons.

(h) The total adjusted basis and fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the liabilities assumed (as determined under § 357(d)) by Controlled.

(i) The liabilities of Distributing being assumed (as determined under § 357(d)) by Controlled were incurred in the ordinary course of business and are associated with the assets being transferred.

(j) There is no plan or intention by any shareholder who owns five percent or more of the Distributing stock, 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 Proposed Transaction.

(k) 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 Proposed Transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

(l) 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 Proposed Transaction, except in the ordinary course of business.

(m) No intercorporate debt will exist between Distributing (or its affiliates) and Controlled (or its affiliates) at the time of, or after, Distribution 2.

(n) No two parties to the Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(o) Immediately before Distribution 2, 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, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, any excess loss account Distributing may have in Controlled stock will be included in income immediately before Distribution 2 to the extent required by applicable regulations (see § 1.1502-19).

(p) The income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred (if any) will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of property.

(q) For purposes of § 355(d), immediately after Distribution 2, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of Distribution 2.

(r) For purposes of § 355(d), immediately after Distribution 2, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of Distribution 2.

(s) Distribution 2 is not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50 percent or more of the total combined voting power of all classes of either Distributing or Controlled entitled to vote, or stock possessing 50

percent or more of the total value of all classes of stock of either Distributing or Controlled.

(t) Distributing is not an S corporation (under § 1361(a)), and neither Distributing nor Controlled plans to make an S corporation election under § 1362(a) following the Proposed Transaction.

(u) The payment of cash in lieu of fractional shares of Controlled will be solely for the purpose of avoiding the expense and inconvenience to Distributing of issuing fractional shares and does not represent separately bargained-for consideration. The total cash consideration to be paid in lieu of fractional shares of Controlled stock will not exceed one percent of the total consideration that will be issued in the Proposed Transaction to the Distributing shareholders. The fractional share interests of each Distributing shareholder will be aggregated, and no Distributing shareholder will receive cash in an amount equal to or greater than the value of one full share of Controlled stock.

(v) Distributing will use b percent of its stock to make acquisitions in the year following Distribution 2.

(w) Any Compensatory Options granted will contain customary terms and conditions, will be granted in connection with the performance of services for Distributing or Controlled, will not be excessive by reference to the services performed, and, immediately after Distribution 2 and within six months thereafter, (i) will be non-transferable within the meaning of § 1.83-3(d) and (ii) will not have a readily ascertainable fair market value as defined in § 1.83-7(b).

(x) Payments made in connection with any continuing transactions between Distributing (and its subsidiaries) and Controlled (and its subsidiaries) will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

Rulings

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

(1) The Contribution, followed by Distribution 2, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under § 368(b).

(2) No gain or loss will be recognized by Distributing on the Contribution (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled on the Contribution

(§ 1032(a)).

(4) The basis of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).

(5) The holding period of each asset received by Controlled in the Contribution will include the period during which Distributing held that asset (§ 1223(2)).

(6) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholders upon their receipt of Controlled stock in Distribution 2 (§ 355(a)(1)).

(7) The aggregate basis of the Distributing stock and the Controlled stock in the hands of each Distributing shareholder (including fractional share interests to which the shareholder may be entitled) will equal the aggregate basis of the Distributing stock held by that shareholder immediately before Distribution 2, allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(a)(1), (b), and (c)).

(8) The holding period of the Controlled stock received by each Distributing shareholder in Distribution 2 will include the holding period of the Distributing stock on which Distribution 2 is made, provided the Distributing stock is held as a capital asset on the date of Distribution 2 (§ 1223(1)).

(9) No gain or loss will be recognized by Distributing on Distribution 2 (§ 361(c)).

(10) Earnings and profits will be allocated between Distributing and Controlled in accordance with §§ 312(h), 1.312-10(a), and 1.1502-33(e)(3).

(11) If cash is received by a Distributing shareholder as a result of the sale of a fractional share of Controlled stock by Distributing's brokerage firm, the shareholder will have gain or loss measured by the difference between the amount of cash received and the basis of the fractional share (determined under ruling (7) above) (§ 1001). If the Controlled stock is held by the shareholder as a capital asset, the gain or loss will be capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code (§§ 1221 and 1222).

Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed about

the federal tax consequences of the Liquidation, Distribution 1, the Cancellation, or the Acquisitions, including whether any of the Acquisitions should be considered an expansion of Business C under § 1.355-3(b)(3)(ii).

Procedural Statements

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

Each taxpayer affected by the Proposed Transaction should attach a copy of this ruling letter to its, his, or her federal tax return for the taxable year in which the Proposed Transaction is completed.

Under a power of attorney on file in this office, a copy of this ruling letter is being sent to your authorized representative.

Sincerely,
Assistant Chief Counsel (Corporate)
By: Wayne T. Murray
Senior Technician/Reviewer
Branch 4