

INTERNAL REVENUE SERVICE  
Index Number: 355.01-00

Number: **199914007**  
Release Date: 4/9/1999

CC:DOM:CORP:1 PLR-107515-98  
December 23, 1998

Re:

Distributing =

Controlled =

Holding Company =

State A =

Business 1 =

Business 2 =

Z =

ZF =

x =

p =

q =

r =

s =

t =

u =

m date =

n date =

Dear :

This is in reply to a letter dated March 13, 1998, requesting rulings as to the federal income tax consequences of certain proposed transactions. Additional information was submitted by letters dated July 15, 1998 and December 28, 1998. The information submitted for consideration is substantially as set forth below.

The rulings contained in this letter are predicated 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 this request for ruling. Verification of the factual information, representations, and other data may be required as part of the audit process.

Distributing is a State A corporation which is engaged in Business 1, a regulated business. Distributing is also engaged in Business 2 through Controlled, its wholly-owned unregulated State A subsidiary. Distributing is publicly traded and as of December 31, 1997, had authorized p shares of common stock of which q shares were issued and outstanding. As of December 31, 1997, Distributing also had authorized r shares of nonvoting cumulative preferred stock of which s shares were issued and outstanding in six series.

As of December 31, 1997, Controlled had authorized t shares of common stock, of which u shares were issued and outstanding.

Financial information has been received which indicates that Distributing and Controlled 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's Business 1 is subject to the regulatory authority of Z, a State A agency and ZF, a federal agency. Under the State A regulatory law, Distributing must obtain approval from Z each time it invests in or loans money to its nonregulated subsidiary Controlled. The taxpayer has represented that the approval process is expensive and time-consuming, and that processing delays have caused Controlled to lose out on business opportunities.

On m date, Z issued an order recommending that companies, including Distributing, divest themselves of x assets. After negotiations with Z, a settlement agreement, which was later modified by Z, was approved by Z. The settlement

agreement provides that Distributing will structurally separate its assets by a date (or earlier if required by Z).

Therefore, to comply with the settlement agreement, the taxpayer proposes the following steps to separate its regulated and nonregulated businesses:

- (i) Distributing will form Holding Company.
- (ii) Holding Company will exchange all of its common stock with Distributing's shareholders on a share for share basis for all of the outstanding shares of Distributing's common stock.
- (iii) When the share exchange is consummated, holders of Distributing common stock who do not vote for the Holding Company formation and who timely dissent will have certain statutory appraisal rights. The terms of the share exchange require that anyone choosing to dissent must surrender all of their Distributing stock.
- (iv) Upon consummation of the share exchange, each nondissenting holder of Distributing's common stock immediately prior to the share exchange will own a corresponding number of shares and percentage of the outstanding Holding Company common stock. Holding Company will own all of the outstanding shares of Distributing's common stock not subject to appraisal rights.
- (vi) Following the share exchange, Distributing will distribute to Holding Company all of the stock of Controlled.

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

- (a) There will be no transfers of property by Distributing to Controlled in connection with the transaction. Controlled is not assuming liabilities nor receiving assets subject to liabilities.
- (b) No part of the consideration to be distributed by Distributing will be received by Holding Company as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) No part of the consideration to be distributed by Distributing will be received by a security holder as an employee or in any capacity other than that of a security holder of the corporation.
- (d) 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 each corporation, there have been no substantial operational changes since

the date the last financial statements were filed.

(e) Following the transaction, Distributing and Controlled will each continue the active conduct of their respective businesses independently and with their separate employees.

(f) The distribution of the stock of Controlled is carried out for the following corporate business purposes: (1) to implement the corporate restructuring authorized by the settlement agreement whereby, among other things, Distributing is authorized to divest itself of Controlled, and (2) to provide financial flexibility to act quickly to take advantage of business opportunities and to respond to changes in the business environment. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.

(g) There is no plan or intention by Holding Company, 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 share exchange, other than in the ordinary course of business.

(h) 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 assets of either corporation subsequent to the transaction, except in the ordinary course of business and except as required by the settlement agreement regarding x assets of Distributing.

(i) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.

(j) 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 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as 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).

(k) 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.

(l) Distributing, Controlled, and the shareholders of Distributing will each pay their own expenses, if any, incurred in connection with the distribution.

(m) Distributing shareholders will not increase their basis in the enterprise

conducted by Holding Company as a result of the transfer.

(n) Within the five year period preceding the date Holding Company acquires control of Distributing, no person (including all persons related to such person within the meaning of § 267(b) and § 707(b)(1) of the Code) or any group of persons acting in concert purchased as much as 50 percent of the outstanding stock of Distributing.

(o) The Distribution 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 stock of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

Based solely on the information submitted and on the representations set forth above, it is held as follows:

(1) No gain or loss will be recognized to Distributing on the distribution of the Controlled stock (§ 355 (c)).

(2) No gain or loss will be recognized by Holding Company upon the receipt of the Controlled stock (§ 355 (a)(1)).

(3) The basis of the stock of Distributing and Controlled in the hands of Holding Company after the distribution will be the same as the aggregate 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) of the Income Tax Regulations (§ 358(b)(2)).

(4) The holding period of the Controlled stock received by Holding Company will include the holding period of Distributing stock with respect to which the distribution will be made, provided that Distributing stock is held as a capital asset on the date of the exchange (§ 1223(1)).

(5) As provided in § 312 (h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10 (b).

No opinion is expressed about the tax treatment of the proposed transaction under any other provisions of the Code and regulations or about 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, pursuant to Rev. Proc. 98-3 § 3.01(22), we express no opinion regarding whether § 351 applies to the formation of Holding Company.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter (including regulations under § 358(g)) have not yet been adopted.

Therefore, this ruling will be modified or revoked if adopted temporary or final regulations are inconsistent with any conclusions in the ruling. See, § 12.04 of Rev. Proc. 98-1, 1998-1 I.R.B. 7. However, when the criteria in § 12.05 of Rev. Proc. 98-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

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

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to your authorized representatives.

Sincerely,  
Assistant Chief Counsel (Corporate)

By \_\_\_\_\_  
Howard Staiman  
Assistant Branch Chief, Branch 1