

**Internal Revenue Service**

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**200014039**  
Department of the Treasury

Washington, DC 20224

Person to contact:

Telephone Number:

Refer Reply To:

**CC:DOM:CORP:3-PLR-115570-99**

Date:

January 5, 2000

Parent =

Distributing =

Controlled =

Corporation X =

Corporation Y =

State A =

State B =

State A Institution =

Business 1 =

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Business 2 =Business 3 =Business 4 =Business 5 =

Other =

a =

b =c =d =e =f =

This letter responds to a request dated September 15, 1999 for rulings relating to the federal income tax treatment of a proposed transaction. We have received additional information in letters dated December 1, 1999 and December 17, 1999. The information submitted for consideration is summarized below.

Parent is a State A holding company and the parent of the consolidated group which includes Distributing, Controlled, Corporation X, and Corporation Y.

Distributing is a State A Institution engaged in Business 1. Distributing is an accrual basis taxpayer that maintains its books on a calendar year basis. Distributing has two classes of stock issued and outstanding: voting common stock and nonvoting

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cumulative preferred stock. Distributing has a shares of voting common stock and b shares of nonvoting cumulative preferred stock issued and outstanding. Distributing's voting common stock is owned substantially by Parent (greater than 80%).

Controlled is a State A corporation engaged in Business 2 and to a limited extent, Business 4. Controlled is an accrual basis taxpayer that maintains its books on a calendar year basis. Controlled has c shares of voting common stock issued and outstanding. Controlled's voting common stock is owned d% by Distributing (greater than 80%) and e% by Corporation X, another greater than 80% subsidiary of Parent.

Corporation Y is a State B corporation engaged in Business 3. Controlled owns f% of Corporation Y.

Information has been received indicating Controlled's need for expansion and diversification of its business activities and relationships. To effectuate this need, Controlled plans to (1) leverage off the existing infrastructure of equipment and management experience in Business 4 to other industries and (2) exploit its current infrastructure to launch a new business, Business 5.

State A and federal laws provide that a subsidiary of a State A Institution is restricted to engaging in activities which are part of, or incidental to the business of a State A Institution. Distributing contends that, under Parents existing corporate structure, Controlled's expansion of Business 4 and operation of Business 5 would violate the aforementioned laws. Distributing has concluded that Controlled's plans can only be accomplished with the distribution of stock in Controlled to an entity which is not a State A institution.

To accomplish this objective, the taxpayer has proposed that Distributing will distribute all of its stock in Controlled pro rata to Distributing's shareholders. <sup>e</sup> Controlled stock issued to Distributing's shareholders will be in a number of shares equal to the pro rata share of each of the Distributing shareholders' respective holdings in Distributing, multiplied by Distributing's overall stock ownership in Controlled (the "Proposed Transaction").

The taxpayer has made the following representations in connection with the Proposed Transaction:

- (a) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.

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- (b) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) The five years of financial information submitted on behalf of Controlled is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes **since** the date of the last financial statements submitted.
- (d) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees. Controlled will continue to provide Business 2 services to Distributing at rates charged in an arms length transaction. In addition, Controlled provides Other services to Distributing at rates reflective of the fair value of such Other services in the open market.
- (e) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to enable expansion into new areas of business which are not permitted activities for a subsidiary of a State A Institution and to comply with statutory and regulatory requirements regarding permissible State A Institution subsidiary activities. The distribution of the stock of Controlled is motivated in whole or substantial part by this corporate business purpose.
- (f) Distributing is not an **S** corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing or Controlled to make an **S** corporation election pursuant to § 1362(a).
- (g) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their 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 § 4.05(l)(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 after the transaction, except in the ordinary course of business.

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- (j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock except that in the ordinary course of business, Controlled provides services to Distributing for which it charges Distributing amounts at the same rates charged to unrelated third party customers of Controlled. The charges are usually settled a month in arrears so it is not unusual for Controlled to carry accounts receivable due from Distributing. The accounts are normally settled on a monthly basis at the same terms Controlled offers to third party customers. It is anticipated Controlled will continue to provide and charge for these services for Distributing after the distribution.
- (k) 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. Further, Distributing has no excess loss account with respect to the Controlled stock.
- (l) 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.
- (m) 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, we hold as follows:

- (1) No gain or loss will be recognized by Distributing upon the distribution of all of its stock in Controlled to the shareholders of Distributing. Section 355(c)(l).
- (2) No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing upon the receipt of the Controlled stock distributed to them in the distribution. Section 355(a)(l).
- (3) The aggregate basis of Distributing and Controlled stock in the hands of each Distributing shareholder after the distribution will, in each instance, equal the basis of the Distributing stock held by such shareholder immediately before the

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distribution, allocated between the Distributing stock and Controlled stock in proportion to the relative fair market value of each in accordance with § 1.358-2(a)(2). Sections 358(a), (b) and (c).

- (4) The holding period of the Controlled stock that each Distributing shareholder receives will include the holding period of the Distributing stock with respect to which the distribution will be made, provided the Distributing stock is held as a capital asset by such shareholder on the date of the distribution. Section 1223(1).
- (5) Proper allocation of, and adjustments to, earnings and profits between Distributing and Controlled will be made in accordance with §§ 1.312-10(b) and 1.1502-33.

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,

The rulings contained in this letter are 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 rulings, it is subject to verification on examination.

This **ruling** is directed only to the taxpayer(s) 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.

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A **copy** of this letter must be attached to any income tax return to which it is relevant.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By *Ken Cohen*

Ken Cohen  
Senior Technical Reviewer, Branch 3