

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

**CC:DOM:CORP:1-PLR-114099-99**

Date:

**February 4, 2000**

Re:

Corporation X =

Corporation Y =

Distributing =

Controlled =

Corporation Z =

State A =

Date A =

Business A =

Business B =

aaa =

bbb =

Investment Advisor A =

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Investment Advisor B =

Dear :

This is a reply to your letter dated August 17, 1999 requesting rulings under § 355 of the Internal Revenue Code (the "Code") and other Code sections, as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated October 26, 1999; November 8, 1999; December 6, 1999; December 22, 1999 and January 18, 2000. The information submitted for consideration is substantially as set forth below.

Distributing, a publicly traded State A corporation, is the common parent of an affiliated group that files a consolidated federal income tax return. Distributing is a holding company that, through its various tiers of subsidiaries, engages in Business A, Business B and other related businesses. As of Date A, Distributing had one shareholder holding 5 percent or more of Distributing's only class of common stock; the shareholder holds bbb% of Distributing's shares outstanding.

Corporation X is one of several first-tier subsidiaries wholly owned by Distributing. Corporation X directly engages in Business A. Corporation Z is also a first-tier subsidiary wholly owned by Distributing that directly engages in Business A. Unlike Corporation X, many employees of Corporation Z are members of aaa, a labor union. Corporation Y is one of two subsidiaries wholly owned by Corporation X that directly engages in Business B. Corporation Y has had a volatile earnings history.

Financial information has been received indicating that Business A, conducted by Corporations X and Z, and Business B, conducted by Corporation Y, have each had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Companies engaged in Business A have been consolidating during the past decade. Accordingly, Corporation X wants to acquire other corporations engaged in Business A.

However, Corporation X's ability to raise capital through a stock offering is hampered by its ownership of Corporation Y. According to Investment Advisor B, Corporation Y's continued affiliation with Corporation X would lower Corporation X's overall valuation in the marketplace because of Corporation Y's volatile earnings history.

Further, based on financial analyses provided by Investment Advisor A and Investment Advisor B, Corporation X has concluded that its ability to raise capital is severely constrained by its affiliation with Corporation Z and the union membership of Z's

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employees. The price earnings ratio of Distributing is considerably lower than the price earnings ratio of Distributing's peers in Business A. Investment Advisor A has advised that separation of Corporation X from Distributing, and thereby Corporation Z, would allow proper valuation of Corporation X for purposes of a stock offering (through Controlled).

In order to accomplish the above, the following transaction is proposed:

1. Corporation X will distribute all outstanding Corporation Y stock to Distributing (the "First Distribution").
2. Distributing will form Controlled, a holding company, as a first-tier subsidiary.
3. Distributing will contribute all outstanding Corporation X stock to Controlled (the "Contribution").
4. Distributing will distribute all outstanding Controlled stock to the Distributing shareholders pro rata (the "Second Distribution"). No fractional shares will be issued in the transaction. Shares representing aggregate fractional share interests will be sold by an independent distribution agent on the open market. The proceeds of such sale will be distributed to Distributing shareholders entitled to such fractional share interests.
5. Within one year of the Second Distribution, Controlled will issue stock in a public offering or acquisition. Such stock issuance will not exceed 50 percent of the total outstanding stock of Controlled by vote or value.

The following representations have been made by the taxpayer in connection with the Step 1:

- (a) Any indebtedness owed by Corporation Y to Corporation X after the first distribution will not constitute stock or securities.
- (b) No part of the consideration distributed by Corporation X will be received by Distributing as a creditor, employee, or in any capacity other than that of a shareholder of Corporation X.
- (c) The five years of financial information submitted on behalf of Corporation X is representative of Corporation X's present operation and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statement submitted.
- (d) The five years of financial information submitted on behalf of Corporation Y is

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representative of Corporation Y's present operation and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statement submitted.

- (e) The First Distribution is carried out for the following business purpose: Stock Offering - to position the Controlled affiliated group to raise capital and make acquisitions through a public offering of the common stock of Controlled for cash using the proceeds as acquisition capital, and/or the use of the common stock of Controlled as acquisition capital. The First Distribution is motivated in whole, or in substantial part, by the above business purpose.
- (f) Distributing has no plan or intention to sell, transfer by gift or otherwise dispose of any of its stock in, or securities of, either Corporation X (other than as provided with respect to the Contribution and Second Distribution) or Corporation Y after the transaction.
- (g) There is no plan or intention by Corporation X or Corporation Y, 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 Revenue Procedure 96-30.
- (h) There is no plan or intention to liquidate either Corporation X or Corporation Y, to merge either Corporation X or Corporation Y 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.
- (i) Except for the possible open book account items, which will be settled within 30 days of the date of the above transaction, no intercorporate debt will exist between Corporation X and Corporation Y at the time of, or subsequent to, the distribution of the Corporation Y common stock.
- (j) Immediately before the First Distribution, items of income, gain, loss, deduction and credit will be taken into account as required by the 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, Corporation X's excess loss account with respect to Corporation Y's common stock, if any, will be included in income immediately before the Distribution (See § 1.1502-19).

The following representations have been made by the taxpayer in connection with Steps 3 and 4:

- (a) The indebtedness owed by Controlled to Distributing after the second distribution will not constitute stock or securities.

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- (b) No part of the consideration distributed by Distributing will be received by a shareholder of Distributing as a creditor, employee or in any capacity other than that of a shareholder in Distributing.
- (c) The five years of financial information submitted on behalf of Corporation Z 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 statement submitted.
- (d) Immediately after the Second Distribution, at least 90% of the fair market value of the gross assets of Distributing will consist solely of the stock and securities of Corporation Y and Corporation Z, controlled corporations that are engaged in the active conduct of a trade or business as defined in Section 355(b)(2).
- (e) Immediately after the Second Distribution, at least 90% of the fair market value of the gross assets of Controlled will consist solely of the stock and securities of Corporation X, a controlled corporation that is engaged in the active conduct of a trade or business as defined in Section 355(b)(2).
- (f) The Contribution and Second Distribution will be carried out for the following corporate business purposes: (i) Stock Offering- to position the Controlled affiliated group to raise capital and make acquisitions through a public offering of the common stock of Controlled for cash using the proceeds as acquisition capital, and/or the use of the common stock of Controlled as acquisition capital; and (ii) Fit and Focus- to position and allow Corporation X, as a subsidiary of Controlled, and Distributing (through its operating subsidiaries) to pursue separate strategies that are necessary to enhance each company's performance and allow each company to remain competitive, by eliminating systemic management, operational and financing issues and problems, which arise out of, or are exacerbated by, Distributing's ownership within the same affiliated group of Corporation X and Corporation Z; and (iii) Key Employee- Stock Ownership- to position Corporation Z to negotiate and organize an employee stock ownership plan for the benefit of employees of the Distributing affiliated group. The Contribution and Second Distribution are motivated in whole or substantial part, by the above business purposes.
- (g) There is no plan or intention by the shareholder who owns five percent or more of the stock of Distributing and the management of Distributing, to the best of its knowledge, is not aware of any plan or intention on the part of any remaining shareholder 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, other than the sale of fractional shares through the exchange agent.
- (h) There is no plan or intention by Distributing or Controlled, directly or through any

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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 Revenue Procedure 96-30.

- (i) There is no plan or intention to liquidate either Distributing or Controlled, to merge either Distributing or Controlled with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except for transactions in the ordinary course of business.
- (j) Except for possible open book account items, which will be settled within 30 days of the date of the above transaction, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the stock of Controlled.
- (k) Immediately before the Second Distribution, items of income, gain, loss, deduction and credit will be taken into account as required by the 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 Controlled's common stock, if any, will be included in income immediately before the Distribution (See § 1.1502-19).
- (l) Payments made in connection with all 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.
- (m) Neither Distributing nor Controlled is, or will be, an investment company as defined in §§ 368(a)(2)(F)(iii) and (iv).
- (n) The sale of fractional shares and the receipt by shareholders of cash in lieu of fractional shares will be solely for the purpose of avoiding the expense and inconvenience of issuing fractional share interests and will not represent the sale of fractional shares, and will not represent consideration that was separately bargained for. An independent agent will conduct the sale of fractional shares and neither Distributing nor Controlled will purchase any of the shares so sold. The total cash consideration that will be received by the Distributing shareholders in lieu of fractional shares will not exceed one percent of the total value of all of the Controlled stock. The fractional share interest of each such 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 common stock.

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Based solely on the information submitted and on the representations set forth above, it is held as follows with respect to Step 1:

- (a) No gain or loss will be recognized by (and no amount will be included in the income of) Corporation X as a result of the distribution of the Corporation Y stock pursuant to the first distribution. Section 355(c).
- (b) No gain or loss will be recognized by (and no amount will be included in the income of) Distributing upon or as a result of the receipt of the Corporation Y stock pursuant to the first distribution. Section 355(a)(1).
- (c) The aggregate basis of the stock of Corporation X and Corporation Y in the hands of Distributing after the first distribution will be the same as the basis of the Corporation X common stock held by Distributing immediately before the first distribution, allocated in proportion to the fair market value of each in accordance with 1.358-2(a)(2). Section 358(a)(1) and (b).
- (d) The holding period of the Corporation Y common stock received by Distributing will include the holding period of the Corporation X common stock with respect to which the distribution will be made, provided that the Corporation X common stock is held as a capital asset on the date of the distribution. Section 1223(1).
- (e) Proper allocation of the earnings and profits between Corporation X and Corporation Y will be made under § 1.312-10(b) .

Based solely on the information submitted and on the representations set forth above, it is held as follows with respect to Steps 3 and 4:

- (a) The Contribution followed by the Second Distribution will be a reorganization under § 368(a)(1)(D). Distributing and Controlled will each be a "party to the reorganization" within the meaning of § 368(b).
- (b) No gain or loss will be recognized by Distributing on the contribution of the stock of Corporation X in constructive exchange for Controlled stock. Section 361(a) .
- (c) No gain or loss will be recognized by Controlled on the receipt of the stock of Corporation X in connection with the transaction in constructive exchange for Controlled stock. Section 1032(a).
- (d) 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. Section 362(b).

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- (e) The holding period of each asset received by Controlled in the Contribution will include the period during which Distributing held that asset before the Contribution. Section 1223(2).
- (f) No gain or loss will be recognized by Distributing on the Second Distribution. Section 361(c)(1).
- (g) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the holders of Distributing common stock on receipt of Controlled common stock pursuant to the Second Distribution (including fractional share interests). Section 355(a)(1).
- (h) The holding period of Controlled common stock (including fractional share interests) received by holders of Distributing common stock will include the holding period of the Distributing common stock on which the Second Distribution is made, provided the Distributing common stock is held as a capital asset on the date of the Second Distribution. Section 1223(1)(B).
- (i) The earnings and profits of the Distributing and Controlled will be allocated as provided in §§ 312(h), 1.312-10(a) and 1.1502-33(f)(2).
- (j) A holder of a fractional share interest in Controlled will recognize gain or loss on the sale of the fractional share interest equal to the difference between the cash received and the holder's basis in such interest (§ 1001). Provided the fractional share interest is a capital asset in the hand of the exchanging holder, such gain or loss will be capital gain or loss to such holder subject to the provisions and limitations of Subchapter P and Chapter 1 of the Code.
- (k) The aggregate basis of the Distributing common stock and the Controlled common stock in the hands of a holder of Distributing stock will equal the aggregate basis of the Distributing common stock held immediately before the Second Distribution by that shareholder, allocated between the Distributing common stock and the Controlled common stock in proportion to the relative fair market value of each on the date of the Second Distribution. Section 358(a)(1) and (b) and Treas. Reg. § 1.358-2(a)(2).

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about the tax treatment of an conditions existing at the time of, or effects resulting from, the proposed transactions that are not specifically covered by the above rulings.

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.

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A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this ruling are consummated.

Sincerely,

Assistant Chief Counsel (Corporate)

By:

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Christopher W. Schoen  
Assistant to the Chief, Branch 1