

**Internal Revenue Service**

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Old Parent =

Distributing =

Controlled =

LLC =

business m =

business n =

acquisition A =

acquisition B =

state X =

state Y =

Date 1 =

This letter responds to your request dated September 15, 1999, for rulings as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated December 6, 1999, January 14, 2000, January 16, 2000, February 18, 2000, March 8, 2000, and March 16, 2000. The information submitted is summarized below.

Distributing is a state X corporation engaged in business m. Distributing is widely held and publicly traded, and has a single class of voting common stock outstanding. Distributing is the common parent of a consolidated group of corporations which includes Controlled, and has a taxable year ending December 31.

Prior to Date 1 (which is less than 2 years before the date of your ruling request for the proposed transaction), Distributing was a subsidiary of Old Parent. On Date 1,

Old Parent spun off Distributing in a transaction intended to qualify as a tax free distribution under §§ 355 and 368(a)(1)(D) (the "Prior spin-off"). Also on Date 1, Old Parent stock was acquired in acquisitions A and B (the "Acquisitions"). In connection with the Prior spin-off, Old Parent transferred the stock of Controlled to Distributing. No ruling letter was requested with respect to the Prior spin-off.

Controlled is a state X corporation engaged in business n. Controlled is a wholly owned subsidiary of Distributing with a single class of voting common stock outstanding and a taxable year ending December 31. Controlled has one subsidiary, LLC, which is a single member LLC that is disregarded as a separate entity for federal tax purposes.

Financial information has been submitted indicating that Distributing's business m, Controlled's business n, and LLC 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. Distributing has received a letter from an investment banker advising Distributing that, to reduce Distributing's outstanding indebtedness, to diminish the risk of default under an existing loan agreement, and to raise working capital to support the intended expansion of Controlled's business n, Distributing should offer common stock of Controlled to the public and then separate Controlled from Distributing's consolidated group. The investment banker advised Distributing that the proceeds from a public offering of Controlled stock will be maximized if Controlled is spun off, and that a public offering of the stock of Controlled will be a more effective way of raising capital for Distributing than alternative methods.

A separate investment banker letter also specified that the proceeds from the public offering of Controlled will be enhanced if LLC were spun off to Distributing prior to the public offering. The letter stated that, because LLC is not engaged in business n, Controlled will be valued more accurately by investors if it is disaffiliated from LLC.

Accordingly, the following transaction has been proposed:

- (1) Controlled will transfer its ownership interest in LLC and the liabilities associated with LLC, including assets subject to liabilities, to a newly formed, wholly owned subsidiary ("Newco").
- (2) Controlled will distribute all of its Newco stock to Distributing (together with step (1), the "first spin-off").
- (3) Distributing will issue up to 20% of the stock of Controlled in an initial public offering (the "IPO").
- (4) Distributing will distribute, pro rata to its shareholders, all of its shares of Controlled common stock, which will represent at least 80% of the total voting power and at least 80% of the total number of shares of the Controlled common stock (the "second spin-off").

Information has been submitted, and a representation has been made, indicating that at the time of the Acquisitions, Distributing and its controlling shareholders did not intend to spin off Controlled. The following representations have been made in connection with the first spin-off:

- (a) No part of the consideration distributed by Controlled will be received by a shareholder as a creditor, an employee, or in any capacity other than that of a shareholder of Controlled.
- (b) The financial information submitted on behalf of Controlled, including the information submitted with respect to the operations of LLC's business, is representative of Controlled's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the proposed transaction, Controlled and Newco will each continue the active conduct of its business, independently and with its separate employees.
- (d) The distribution of the stock of Newco will be carried out for the following corporate business purpose: to facilitate the IPO. The distribution of the stock of Newco is motivated in whole or substantial part by this corporate business purpose.
- (e) Other than the dispositions of Controlled stock pursuant to the IPO and the second spin-off, there is no plan or intention by the shareholders or security holders of Controlled to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Controlled or Newco after the transaction.
- (f) There is no plan or intention by either Controlled or Newco, 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(1)(b) of Rev. Proc. 96-30.
- (g) There is no plan or intention to liquidate either Controlled or Newco, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the distribution, except in the ordinary course of business.
- (h) The total adjusted bases and the fair market value of the assets transferred to Newco by Controlled each equals or exceeds the sum of the liabilities assumed by Newco plus any liabilities to which the transferred assets are subject. The liabilities assumed by Newco and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (i) Controlled neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the proposed transaction.

(j) No intercorporate debt will exist between Controlled and Newco at the time of, or subsequent to, the proposed transaction.

(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.

(l) Payments made in connection with all continuing transactions, if any, between Controlled and Newco will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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

The following representations have been made in connection with the second spin-off:

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

(o) The five years of financial information submitted on behalf of Distributing and Controlled is representative of their present operations, and with regard to each such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(p) Following the proposed transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees, with the exception of certain management services that may be supplied by Distributing to Controlled.

(q) The distribution of the stock of Controlled will be carried out for the following corporate business purpose: to facilitate the IPO for purposes of raising capital for the reduction of Distributing's debt and the expansion of Controlled's business n. The distribution of the stock of Controlled is motivated in whole or substantial part by this corporate business purpose.

(r) 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.

(s) 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(1)(b) of Rev. Proc. 96-30.

- (t) 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 distribution, except in the ordinary course of business.
- (u) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the proposed transaction.
- (v) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the proposed transaction.
- (w) 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. Furthermore, Distributing's excess loss account (if any) with respect to the Controlled stock will be included in income immediately before the distribution (see § 1.1502-19).
- (x) 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.
- (y) No two parties to the transaction are investment companies as defined in §§ 368(a)(2)(F)(iii) and (iv).
- (z) At the time of the Acquisitions, Distributing and its controlling shareholders, determined immediately after each respective Acquisition, did not intend to effectuate the distribution of Controlled stock.
- (aa) The Distribution is not part of a plan or series of related transactions (within the meaning of section 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, with respect to the first spin-off, as follows:

- (1) The transfer by Controlled to Newco described above in exchange for all the stock of Newco and the assumption of liabilities followed by the distribution of Newco stock to Distributing will qualify as a reorganization within the meaning of § 368(a)(1)(D). Controlled and Newco will each be a "party to the reorganization" within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Controlled upon the transfer of assets to Newco in exchange for Newco stock and the assumption of liabilities (§§ 357(a) and 361 (a)).

- (3) No gain or loss will be recognized by Newco on the receipt of assets in exchange for all the shares of Newco (§ 1032).
- (4) The basis of the assets received by Newco will be the same as the basis of such assets in the hands of Controlled immediately prior to the transaction (§ 362(b)).
- (5) The holding period of each asset received by Newco will include the period during which Controlled held the asset (§ 1223(2)).
- (6) No gain or loss will be recognized by Controlled upon the distribution of its Newco stock (§ 361(c)).
- (7) No gain or loss will be recognized by Distributing (and no amount will be included in its income) upon the receipt of the Newco stock (§ 355(a)(1)).
- (8) Distributing's basis in the Controlled stock and the Newco stock will be the same as Distributing's aggregate basis in the Controlled stock 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)).
- (9) Distributing's holding period for the Newco stock will include the period for which Distributing held the Controlled stock, provided that such stock was held as a capital asset by such shareholder on the day of distribution (§ 1223(1)).
- (10) Earnings and profits will be allocated between Controlled and Newco in accordance with § 1.312-10(a).

Based solely on the information submitted and on the representations set forth above, it is held, with respect to the second spin-off, as follows:

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

(5) Earnings and profits will be allocated between Distributing and Controlled in accordance with §§ 1.312-10(b) and 1.1502-33(e).

(6) For purposes of § 355(e), the Acquisitions will not be considered part of a plan or series of transactions related to the second spin-off.

We express no opinion about the tax treatment of the transactions under other provisions of the Internal Revenue Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings. We specifically express no opinion about the tax treatment of the Prior spin-off or the Acquisitions, except as provided in ruling (6) concerning the second spin-off.

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.

Sincerely yours,  
Assistant Chief Counsel (Corporate)  
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Assistant to the Chief, Branch 3