

Internal Revenue Service

Department of the Treasury

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Date:

December 26, 2001

LEGEND

Distributing =

Controlled =

Controlled Sub 1 =

Distributee =
Parent =

Parent Shareholder =

Sub 1 =

Sub 2 =

Business A =

Business B =

Business C =

Industry A =

State A Commissioner =

State Act =

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Year 1 =

Year 2 =

Year 3 =

Date A =

State A =

Country A =

This letter responds to your September 6, 2001 request for rulings regarding certain federal income tax consequences of a proposed transaction. The information submitted in that request and in additional correspondence is summarized below.

SUMMARY OF FACTS

Parent is the domestic common parent of an affiliated group of corporations filing a consolidated federal income tax return and is the primary domestic holding company for the domestic Industry A interests of Parent Shareholder, which is incorporated in Country A. Parent acquired Sub 1 on Date A. Sub 1 owns all of the issued and outstanding stock of Sub 2. Sub 2 owns all of the issued and outstanding stock of Distributee. Parent, Sub 1, Sub 2 and Distributee are not subject to regulation by the State A Commissioner.

Distributing, a wholly owned subsidiary of Distributee, is a State A corporation that incorporated in Year 1. Distributing has one class of capital stock issued and outstanding. Distributing is regulated by the State A Commissioner. Distributing is engaged, both directly and indirectly, in Business A.

Controlled, a wholly owned holding company of Distributing, is a State A corporation that incorporated in Year 2. Controlled has one class of capital stock issued and outstanding, and is not subject to regulation by the State A Commissioner.

Controlled Sub 1, a wholly owned subsidiary of Controlled, is a State A corporation that incorporated in Year 3. Controlled Sub 1 has one class of capital stock issued and outstanding, and is not subject to regulation by the State A Commissioner. Controlled, indirectly through Controlled Sub 1, is engaged in Business B.

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

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As a State A regulated company, Distributing is subject to State Act. Under State Act, Distributing must obtain approval from State Commissioner each time before it makes a distribution to Distributee or indirectly to Parent. For example, if Distributing wishes to distribute Controlled Sub 1 funds to Distributee, State Commissioner must approve the distribution in advance. Distributing incurs unnecessary costs and is caused to allocate employee resources inefficiently each time that it seeks this approval. Restrictions imposed by State A regulatory law further prohibit Controlled Sub 1 from aligning with other corporations engaged in Business B. Distributing represents that these regulatory restrictions are, and will be, burdensome and has explained how eliminating these burdens will help Distributing, Controlled Sub 1 and the Parent group.

Accordingly, Distributing intends to separate Business A and Business B (which it indirectly controls) by distributing 100 percent of the issued and outstanding stock of Controlled to Distributee (the "Distribution"). As a result, Controlled will become, and Distributing will remain, a first-tier subsidiary of Distributee.

REPRESENTATIONS

- (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 Distributing.
- (b) The five years of financial information submitted on behalf of Distributing is representative of its present operations after taking into account the sale of Business C, and with respect to Distributing there have been no substantial operational changes since the date of the last financial statements.
- (c) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of the stock and securities of Controlled Sub 1, a controlled corporation that is engaged in the active conduct of a trade or business, as defined in section 355(b)(2).
- (d) The five years of financial information submitted on behalf of Controlled Sub 1 is representative of its present operation, and with regard to Controlled Sub 1 there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the Distribution, Distributing will continue the active conduct of Business A, independently and with its separate employees, and Controlled through Controlled Sub 1 will continue the active conduct of Business B, independently and with its separate employees.
- (f) The Distribution is carried out for the following corporate business

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purpose: to relieve Distributing of its regulatory burdens. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

- (g) There is no plan or intention by Distributee to sell, exchange, transfer by gift, or otherwise dispose of any of its stock in, or securities of, either Distributing or Controlled after the Distribution.
- (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 Distribution, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (i) There is no plan or intention to liquidate either Distributing, Controlled or Controlled Sub 1, 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.
- (j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, 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 (See §1.1502-13 and §1.1502-14 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, Distributing does not have an excess loss account with respect to Controlled's stock.
- (l) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled or Controlled Sub 1, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (m) The effect of the Distribution is neither to increase ownership (combined direct and indirect) in Distributing or Controlled by a disqualified person (within the meaning of section 1.355-6(b)(3)(ii)); nor to provide a disqualified person with a purchased basis in the stock of Controlled.
- (n) 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 entitled to vote, or stock possessing 50 percent or more of the total value of shares of all classes of stock of either Distributing or Controlled.

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RULINGS

Based solely on the information submitted and the representations set forth above, we rule as follows:

- (1) No gain or loss will be recognized by Distributing from the Distribution. Section 355(c).
- (2) No gain or loss will be recognized by (and no amount will be included in the income of) Distributee by reason of the receipt of Controlled stock. Section 355(a)(1).
- (3) The aggregate basis of Distributing and Controlled stock in the hands of Distributee immediately after the Distribution will be the same as the aggregate basis of Distributing stock held by Distributee immediately before the Distribution allocated between Distributing and Controlled stock in proportion to the fair market value of each in accordance with sections 358(a)(1) and (b) and section 1.358-2(a).
- (4) The holding period of Controlled stock received in the Distribution will include the holding period of the Distributing stock with respect to which the Distribution is made, provided that the Distributing stock is held as a capital asset on the date of the Distribution. Section 1223(l).
- (5) Earnings and profits will be allocated between Distributing and Controlled in accordance with sections 312(h) and 1.312-10(b).

CAVEATS

No opinion is expressed about the tax treatment of the transaction under any other provision of the Code or Regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings.

PROCEDURAL STATEMENTS

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

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.

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A copy of this letter must be attached to the federal income tax return of each taxpayer involved for the taxable year in which the transaction is consummated.

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

Sincerely yours,
Steven J. Hankin
Senior Technician Reviewer, Branch 6
Associate Chief Counsel (Corporate)