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Date:
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Distributing =

Controlled =

the Exemption =

Regulators =

Target =

Entity(ies) =

Sub 1 =

Division 1 =

Division 2 =

the Act =

Sub 2 =

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Sub 3 =

Sub 4 =

P 1 =

State W =

State X =

a =

b =

c =

d =

e =

f =

y =

z =

business a =

business b =

business c =

business d =

Date =

Dear :

This letter replies to a request for rulings, dated July 3, 2001, on the federal income tax consequences of a proposed transaction concerning § 355 of the Internal Revenue Code. We received additional information in letters dated August 29,

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September 25, October 18, December 18, December 19, and December 31, 2001. The information submitted for consideration is summarized below.

Distributing is an accrual method State X corporation with non-voting preferred and voting common stock outstanding. Distributing stock is beneficially owned by y members of a family. Distributing conducts business a, business b, business c and business d through multiple subsidiaries, each on the accrual method of accounting. Distributing also operates Division 1 and Division 2 directly. Distributing files a consolidated return on a calendar tax year. Sub 1, Sub 2, Sub 3 and Sub 4 are all State X corporations and members of Distributing's consolidated group. Sub 1, Sub 2, and Sub 3 are wholly-owned by Distributing. Distributing owns z percent of Sub 4. Sub 1 conducts business a; Sub 2 conducts business b; Sub 3 conducts business c; and Sub 4 is an Entity which conducts business d. Distributing's other subsidiaries are also Entities which conduct business d.

We have received financial information indicating that business a, business b, business c and business d had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Distributing is a holding company under the Act. As such, Distributing's ability to operate non-Entity businesses is restricted by the Regulators. Distributing has long had an exemption ("the Exemption") from these restrictions. The Regulators have determined that if Distributing acquires control of another Entity it will lose the Exemption. If Distributing loses the Exemption it will have to divest itself of some businesses. Distributing owns stock in Target which is an Entity (or owns other Entities) under the Act. Regulators have advised Distributing that if it acquires any additional stock in Target it will lose the Exemption. Distributing has been acquiring stock in Target for many years and has documented that ownership of the stock of Target has been an excellent investment, yielding significant income for the Distributing consolidated group. Accordingly, to enable Distributing to purchase additional Target stock without losing the ability of any of its subsidiaries to continue their current businesses or the ability to acquire other businesses, the following transaction has been proposed:

- (i) Sub 1 will merge into a newly-formed limited liability company ("Sub 1 LLC") ("the Sub 1 Merger"). Sub 1 LLC will be a State W or State X LLC that will be wholly-owned by Distributing and will be disregarded as an entity separate from Distributing for Federal income tax purposes under § 301.7701-3(b)(1)(ii) of the Income Tax Regulations.
- (ii) Distributing will transfer (1) the Exemption, (2) a percent of its common stock in Target (b shares or c percent of the total outstanding stock in Target), (3) all of the assets of Division 1, (4) all of the stock in Sub 2, (5) all of the stock of Sub 3, (6) all of its stock of Sub 4, and (7) a minority partnership interest (less than d percent) of P 1 to Controlled, a newly-formed accrual method taxpayer, in

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exchange for common stock of Controlled and the assumption by Controlled of \$e of Distributing's liability associated with the stock of Target and any liabilities of Division 1 ("the Contribution").

- (iii) Controlled will transfer all of the stock of Target (b shares) it received in step (ii) and all of the assets of Division 1 to Sub 2 in constructive exchange for common stock of Sub 2 and the assumption of any liabilities of Division 1 ("the Sub 2 Transaction")
- (iv) Sub 3 will merge into Sub 2 pursuant to the laws of State X. Sub 2 will be the surviving entity and the separate existence of Sub 3 will cease ("the Sub 3 Merger").
- (v) Distributing will distribute all of the Controlled stock to its common shareholders on a pro-rata basis ("the Distribution").
- (vi) Within 6 months of step (v), Distributing will acquire additional common stock of Target for a purchase price of approximately \$f.

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) Pursuant to § 301.7701-3(b)(1)(ii), Sub 1 LLC will be disregarded as an entity separate from Distributing for Federal income tax purposes.
- (b) The Sub 1 Merger will qualify as a tax-free liquidation under § 332.
- (c) The Sub 2 Transaction will qualify as a tax-free transaction pursuant to § 351.
- (d) The Sub 3 Merger will qualify as a tax-free reorganization under § 368(a)(1).
- (e) Distributing formed Sub 2 on Date by transferring business b assets to Sub 2 in a tax-free transaction qualifying under § 351.
- (f) No stock will be issued for services rendered to or for the benefit of Controlled in connection with the Contribution; and no stock will be issued for indebtedness of Controlled that is not evidenced by a security or for interest on indebtedness of Controlled that accrued on or after the beginning of the holding period of Distributing for the debt.
- (g) None of the stock to be transferred is "section 306 stock" within the meaning of § 306(c).
- (h) The Contribution is not the result of a solicitation by a promoter, broker, or investment house.

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- (i) Distributing will not retain any rights in the property transferred to Controlled.
- (j) The value of the stock received in exchange for accounts receivable will be equal to net value of the accounts transferred.
- (k) The total adjusted basis and the fair market value of the property to be transferred to Controlled by Distributing in the Contribution will, in each case, equal or exceed the sum of the liabilities assumed (as determined under § 357(d)) by Controlled.
- (l) The liabilities assumed (as determined under § 357(d)) in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- (m) At the time of the Contribution, there will be no intercorporate debt existing between Distributing and Controlled, and no indebtedness will be created in favor of Distributing as a result of the Contribution.
- (n) The Contribution will occur pursuant to a plan that will be agreed on before the transaction and in which the rights of the parties are defined.
- (o) All exchanges in connection with the Contribution will occur on approximately the same date.
- (p) There is no plan or intention on the part of Controlled to redeem or otherwise reacquire any stock to be issued in the Contribution.
- (q) Taking into account any issuance of additional shares of Controlled stock; any issuance of stock for services; the exercise of any Controlled stock rights, warrants, or subscriptions; a public offering of Controlled stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of Controlled to be received by the shareholders of Distributing, the shareholders of Distributing will be in "control" of Controlled within the meaning of § 368(c) immediately following the Distribution.
- (r) Distributing will receive stock of Controlled approximately equal to the fair market value of the property transferred to Controlled.
- (s) Controlled will remain in existence and retain and use the property transferred to it in a trade or business.
- (t) There is no plan or intention by Controlled to dispose of the transferred property other than in the normal course of business operations.

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- (u) Distributing and Controlled will each pay its own expenses, if any, incurred in connection with the Contribution.
- (v) Controlled will not be an investment company within the meaning of § 351(e)(1) and § 1.351-1(c).
- (w) Distributing is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of § 368(a)(3)(A)) and the stock received in the exchange will not be used to satisfy indebtedness of Distributing.
- (x) Controlled will not be a "personal service corporation" within the meaning of § 269A.
- (y) 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.
- (z) The five years of financial information submitted on behalf of Distributing (the Sub 1 business) is representative of this business' present operations, and with regard to this business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (aa) The five years of financial information submitted on behalf of Controlled and its subsidiaries (Sub 2, Sub 3 and Sub 4) is representative of these businesses present operations, and with regard to these businesses, there have been no substantial operational changes since the date of the last financial statements submitted.
- (bb) Following the Distribution, Distributing (through Sub 1 LLC) and Controlled (through its controlled subsidiaries) will each continue the active conduct of its trade or business independently and with its separate employees. A division of Distributing provides administrative management services to Entities. Distributing will continue to offer this service to subsidiaries held by Controlled after the Distribution. The employees of this division will only be employees of Distributing.
- (cc) Immediately following the Distribution, Distributing (through Sub 1 LLC) will be engaged in the active conduct of a trade or business as defined in § 355(b)(2). The gross assets of the trade or business will have a fair market value that is greater than 5 percent of the total fair market value of the gross assets of Distributing.
- (dd) Immediately following the Distribution, at least 90 percent of the fair market value

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of the gross assets of Controlled will consist of the stock and securities of Sub 2 and Sub 4, controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2). The gross assets of the trades or businesses of each of Sub 2 and Sub 4 will have a fair market value that is greater than 5 percent of the total fair market value of the gross assets of such corporation.

- (ee) The distribution of the stock of Controlled is being carried out to enable Distributing to purchase additional Target stock without losing the ability of any of the corporations discussed above to continue their current businesses or the ability to acquire other businesses. The distribution of the stock of Controlled is motivated in whole, or substantial part, by this corporate business purpose.
- (ff) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing or Controlled subsequent to the proposed transaction.
- (gg) 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.
- (hh) There is no plan or intention to liquidate 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.
- (ii) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled and their respective subsidiaries will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's-length.
- (jj) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany regulations. Further, Distributing's excess loss account, if any, with respect to the Controlled common stock and the excess loss account, if any, with respect to the stock of any subsidiary owned by Controlled directly or indirectly, will be included in income immediately before the Distribution.
- (kk) 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 entity led to vote, or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.
- (ll) 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).

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

- (1) Distributing will recognize no gain or loss on the Contribution (§§ 351(a) and 357(a)).
- (2) Controlled will recognize no gain or loss on the Contribution (§ 1032(a)).
- (3) 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 (§ 362(a)(1)).
- (4) The holding period of each asset received by Controlled in the Contribution will include the holding period of that asset in the hands of Distributing (§ 1223(2)).
- (5) Distributing will recognize no gain or loss on the Distribution (§ 355(c)).
- (6) The Distributing shareholders will not recognize gain or loss (and no amount will be included in the income of the Distributing shareholders) upon the receipt of the Controlled stock, as described above (§ 355(a)(1)).
- (7) The Distributing shareholders' basis in their Distributing common and Controlled common stock after the Distribution will be the same as the aggregate basis of the Distributing common stock held immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) and (a)(4) (§§ 358(a), (b), and (c)).
- (8) The holding period of the Controlled stock in the hands of the Distributing shareholders will include the period for which the shareholder held the Distributing stock with respect to which the Distribution will be made, provided that such stock was held as a capital asset by such shareholder on the date of the Distribution (§ 1223(1)).
- (9) Proper allocation of earnings and profits between Distributing and Controlled will be made under §§ 1.312-10(b) and 1.1502-33.

No opinion has been requested and no opinion is expressed about whether (1) § 351 applies to the creation of Sub 2 in representation (e), above, or (2) the Federal tax consequences of the Sub 1 Merger, the Sub 2 Transaction, or the Sub 3 Merger. Additionally, we express no opinion about the tax treatment of the proposed transaction under 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.

This ruling letter is directed only to the taxpayer who requested it. Section

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6110(k)(3) provides that it may not be used or cited as precedent.

Each affected taxpayer must attach a copy of this letter to the taxpayer's Federal income tax return for the tax year in which the transaction covered by this ruling letter is consummated.

We have sent a copy of this letter to your authorized representative pursuant to the power of attorney on file in this office.

Sincerely yours,
Ken Cohen
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel (Corporate)

cc: