

**Internal Revenue Service**

Department of the Treasury

Number: **200229015**  
Release Date: 7/19/2002  
Index Number: 355.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:CORP:B06-PLR-105619-02  
Date:  
April 10, 2002

In Re:

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Business X =

Business Y =

Class X stock =

Class Y stock =

a% =

b% =

Z =

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Dear

This letter responds to your letter, dated January 23, 2002, submitted on behalf of Distributing requesting rulings under section 355 of the Internal Revenue Code with respect to a proposed transaction. Additional information was submitted in a letter dated March 11, 2002. The information submitted is summarized below.

Distributing is the common parent of an affiliated group of corporations filing a consolidated Federal income tax return. Distributing owns all of the stock of several subsidiaries, including Controlled. Distributing has owned all of the stock of Controlled for more than five years. Controlled is a holding company that owns all of the stock of Sub 1 and Sub 2. Distributing is engaged directly and through certain of its subsidiaries (i.e., other than Controlled) in Business X. Controlled is indirectly engaged, through its ownership of Sub 1 and Sub 2, in Business Y. Sub 1 and Sub 2 are directly engaged in Business Y.

Distributing has two classes of stock outstanding, Class X stock and Class Y stock. The Class X stock reflects the value of the entire Business X plus a% of Business Y. The Class Y stock reflects b% of Business Y.

Distributing started Business Y more than five years ago, building on the organizational and sales techniques it used in conducting Business X. Initially, Business Y was dependent upon Distributing for financial, administrative and managerial support. However, as a mature and growing business, Business Y has begun to compete with Business X for management and financial resources as it developed a distinct and conflicting business model. To resolve these issues, Distributing proposes the following transaction:

- (i) Distributing will distribute a% of the Controlled stock pro rata to the holders of the Class X stock (the "Spin-off").
- (ii) Distributing will distribute b% of the Controlled stock to the holders of the Class Y stock in exchange for all of their Class Y stock (the "Split-off"). The Spin-off and Split-off are sometimes collectively referred to as the "Distribution." Following the Distribution, the Class Y stock will be cancelled and Distributing will only have outstanding a single class of common stock. Further, the board of directors of Distributing and Controlled will not have any overlapping members.
- (iii) Subject to shareholder approval, Controlled will, prior to the Distribution, transfer to Distributing an amount of money to reflect the risk to Distributing of a default by Controlled during the remaining term of certain leases for which Distributing has contingent liability. Because Controlled

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was not obligated to transfer this money to Distributing under the lease assignment, Distributing characterizes this transfer of money as a pre-Distribution dividend to Distributing and eliminated from its income under Treas. Reg. section 1.1502-13(f)(2).

The following representations have been made in connection with the proposed transaction:

- (a) In the case of Distributing shareholders receiving Controlled stock in the Split-off, the fair market value of Controlled stock and other consideration, if any, received by each shareholder of Class Y stock will approximately equal the fair market value of the Class Y stock surrendered by shareholders in the Split-off.
- (b) No part of the Controlled stock to be 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 of Distributing (including certain individuals who acquired stock of Distributing in connection with the performance of services and whose stock remains subject to restrictions).
- (c) Distributing, Controlled and the Distributing shareholders will each pay their own expenses, if any, incurred in connection with the transaction.
- (d) The five years of financial information submitted on behalf of Business X is representative of its present operations and there have been no substantial operational changes in such business since the date of the last financial statements submitted.
- (e) The five years of financial information submitted on behalf of Business Y is representative of its present operations and there have been no substantial operational changes in such business since the date of the last financial statements submitted.
- (f) Following the Distribution, Distributing will be engaged in the active conduct of Business X, independently and with its separate employees.
- (g) Following the Distribution, at least 90% of the fair market value of the gross assets of Controlled will consist of stock of controlled corporations that are engaged in the active conduct of Business Y, independently and with their separate employees.
- (h) The distribution of the Controlled stock is carried out for the following corporate business purpose: fit and focus. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (i) There is no plan or intention by any shareholder who owns 5% or more of the stock of Distributing, and management of Distributing, to its best knowledge, is

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not aware of any plan or intention on the part of any remaining shareholder or security holder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of its stock in either Distributing or Controlled after the Distribution.

- (j) 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 possible purchases by Distributing or Controlled pursuant to open market stock repurchase programs meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696.
- (k) 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 any assets of either corporation subsequent to the Distribution except in the ordinary course of business.
- (l) Distributing neither accumulated its receivables or made extraordinary payment of their payables in anticipation of the transaction.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, except for short-term receivables, if any, arising out of lease assignments and the intercompany services agreement.
- (n) 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. Any assignment agreement between Sub 1 or Sub 2 and Distributing with respect to the leasehold interests held by Distributing are on arm's length terms.
- (o) 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 Treas. Reg. sections 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, Treas. Reg. section 1.1502-13 as published by T.D. 8597).
- (p) The Class X stock and Class Y stock each constitutes stock of Distributing for Federal income tax purposes.
- (q) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in

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section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

- (r) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either: (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (s) The payment of cash in lieu of fractional shares of Controlled stock is solely for the purpose of avoiding the expense and inconvenience to Controlled of issuing and maintaining fractional shares and will not represent separately bargained for consideration. The total cash that will be paid in the transaction to Distributing shareholders in lieu of fractional shares of Controlled stock will not exceed one percent of the total consideration that will be distributed in the transaction.
- (t) 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 as follows:

1. No gain or loss will be recognized by Distributing from the distribution of Controlled stock (section 355(c)).
2. No gain or loss will be recognized by (and no amount will be included in the income of) the holders of Class X or Class Y stock as a result of the Distribution (section 355(a)(1)).
3. A Class Y stock shareholder who receives Controlled stock in the Split-off will have an aggregate adjusted basis in the Controlled stock immediately after the Split-off equal to the aggregate adjusted basis in the shareholder's Class Y stock surrendered in the Split-off (section 358(a)(1)).

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4. A Class X shareholder who receives Controlled stock in the Spin-off will have an aggregate adjusted basis of the Controlled and Distributing stock equal to the aggregate adjusted basis of the Class X stock held immediately before the Spin-off, allocated between the Distributing and Controlled stock in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a) (section 358(a)(1) and (b)).
5. The holding period of the Controlled stock received by the Class Y stock shareholders in the Split-off will include the holding period of the Class Y stock surrendered in exchange therefor, provided that such Class Y shares are held as capital assets on the day of the Distribution. Section 1223(1).
6. The holding period of the Controlled stock received by the Class X stock shareholders in the Spin-off will include the holding period of the Class X stock with respect to which such distribution is made, provided that such Class X shares are held as capital assets on the day of the Distribution. Section 1223(1).
7. Shareholders of Distributing who receive cash in lieu of fractional shares of Controlled stock will recognize gain or loss measured by the difference between the basis of the fractional share received and the amount of cash received (section 1001). If the fractional share qualifies as a capital asset in the hands of the shareholder, the gain or loss will be a capital gain or loss subject to the provisions of Subchapter P of Chapter 1 of the Code.
8. Earnings and profits will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. §§ 1.312-10 and 1.1502-33(e)(3).

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. Specifically, no opinion is expressed concerning the characterization of the transfer of money described in (iii) above.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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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.

Sincerely yours,

*Reginald Mombrun* \_\_\_\_\_

Reginald Mombrun

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Office of Associate Chief Counsel (Corporate)