

## Internal Revenue Service

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## Departments of the Treasury

Washington, D.C. 20224

People to Contact:

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Refer Reply To:

**CC:CORP:1- PLR-129515-02**

Date:

**September 26, 2002**

RE:

Legend:

Distributing =

Controlled =

Subsidiary 1 =

Subsidiary 2 =

Shareholder A =

Shareholder B =

Business A =

Business B =

Business C =

Business D =

Bank =

a =

b =

State A =

Dear :

This letter is in reply to your letter dated May 15, 2002, requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated July 11, August 7, September 3, September 17, and September 26, 2002. The information submitted for consideration is summarized below.

Distributing is an accrual basis State A corporation and the common parent of a consolidated group consisting of Subsidiary 1 and Controlled. Distributing is directly engaged in Business A. Subsidiary 1, a wholly owned of Distributing, is an inactive corporation. Distributing has outstanding a shares of voting common stock, which is equally owned by Shareholder A and Shareholder B.

Distributing wholly owns Controlled, a State A corporation, which is engaged in Business B, Business C, and Business D. Subsidiary 2, a wholly owned subsidiary of Controlled, is engaged in a similar Business C operation.

Financial information has been received which indicates that Distributing's Business A operations and Controlled's Business C and Business D operations 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. Controlled is indebted to Distributing in the amount of \$b ("Debt"), which represents the sum total of cash advanced to Controlled by Distributing in prior years to provide Controlled with funds to operate Business B. Controlled has made no principal or interest payments on the Debt.

Controlled is in the process of expanding the business operations of Business B, Business C, and Business D. As a result, Controlled will need to borrow substantial amounts of capital within the next 12 months in order to finance such expansion. Distributing is also required to borrow to finance its own business operations. Bank, which is the historical lender of both Distributing and Controlled, requires Distributing to act as a guarantor on all loans made from Bank by Controlled so long as Controlled is a subsidiary of Distributing. Such guarantees by Distributing reduce the available line of

credit of Distributing at Bank and thereby impair Distributing's ability to borrow sufficient amounts from the Bank to finance its own business operations. Bank has agreed that if the ownership of the capital stock of Controlled is removed from Distributing, then Distributing will no longer be required to guarantee the loans made by Controlled from Bank.

Accordingly, the following transactions have been proposed:

- (i) Prior to the distribution transaction, the Debt will be canceled by converting it to a capital contribution from Distributing to Controlled on the books of both corporations prior to the spin-off of Controlled from Distributing.
- (ii) Distributing will distribute all of the Controlled stock on a pro rata basis to the shareholders of Distributing.

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

- (a) Distributing, Controlled, and their respective shareholders will each pay their own expenses, if any, incurred in connection with the proposed transaction.
- (b) 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.
- (c) The five years of financial information submitted on behalf of Distributing and Controlled are representative of each corporation's present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the proposed distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with their separate employees.
- (e) The distribution of stock of Controlled is carried out for the following corporate business purpose: to eliminate the requirement that Distributing be required to guarantee the loans of Controlled from Bank. The distribution is motivated in whole or substantial part by this corporate business purpose.
- (f) 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 after the transaction.

(g) 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 purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

(h) 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, except in the ordinary course of business.

(i) No liabilities will be assumed in the transaction and no assets are being transferred subject to liabilities.

(j) No property is being transferred between Distributing and Controlled in which an investment tax credit determined under § 46 of the Internal Revenue Code ("Code") has been (or will be) claimed with respect to any of such property.

(k) No intercorporate debt will exist between Distributing and Controlled at the time of or subsequent to the proposed distribution.

(l) 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, 1995-32 I.R.B. 6, and, as currently in effect, §1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account, if any, with respect to the Controlled stock will be included in income immediately before the distribution (§1.1502-19).

(m) 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.

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

(o) No Distributing shareholder or shareholders will hold immediately after the distribution disqualified stock with the meaning of § 355(d)(3) which constitutes a 50% or greater interest in Distributing or Controlled.

(p) 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% or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50% 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, we hold as follows:

(1) The cancellation by Distributing of the Debt owed to it by Controlled, as described above, in constructive exchange for additional shares of Controlled stock, followed by the distribution of the Controlled stock to the shareholders of Distributing, will be a reorganization within the meaning of § 368(a)(1)(D) of the Code.

(2) Distributing will recognize no gain or loss upon the cancellation of indebtedness in constructive exchange for additional shares of Controlled stock, as described above (section 361(a)).

(3) Controlled will recognize no gain or loss will on the cancellation of indebtedness in constructive exchange for additional shares of Controlled stock, as described above (section 1032(a)).

(4) Distributing will recognize no gain or loss upon the distribution of the Controlled stock to the Distributing shareholders (§ 361(c)).

(5) Distributing will recognize no gain or loss (and no amount will be included in the income of the Distributing shareholders) upon receipt of the Controlled stock (§ 355(a)).

(6) The aggregate basis of the Distributing and Controlled stock held by each Distributing shareholder will equal the aggregate basis of such shareholder's Distributing's stock immediately before the distribution, allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a)(2) (§ 358(a)(1) and (b)).

(7) The holding period of the Controlled stock received by each Distributing shareholder will include the holding period of the Distributing on which the distribution is made, provided that such is held as a capital asset on the date of the distribution (§ 1223(1)).

(8) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under §§ 1.312-10(a) and 1.1502-33(e).

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 any conditions existing at the time of, or effects resulting from, the proposed transaction that are not directly covered by the above rulings.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. 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 transaction covered by this ruling letter is consummated.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of the factual information, representations, and other data may be required as part of the audit process.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to your authorized representative.

Sincerely yours,  
Associate Chief Counsel (Corporate)

By \_\_\_\_\_  
Lisa A. Fuller  
Assistant to Chief, Branch 1