

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:1- PLR-144749-02

Date:
December 13, 2002

Legend

Distributing =

Controlled =

Subsidiary 1 =

Subsidiary 2 =

Subsidiary 3 =

Subsidiary 4 =

Subsidiary 5 =

Subsidiary 6 =

Subsidiary 7 =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Business A =

Agency =

State X =

b =

Dear :

This letter responds to your letter dated August 12, 2002, in which rulings were requested as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated November 6, November 21, November 22, November 25, and December 4, 2002. The information submitted for consideration is summarized below.

Distributing is a closely held State X corporation and the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing is indirectly engaged in Business X through Subsidiary 1, Subsidiary 2, Subsidiary 3, Subsidiary 4, Subsidiary 5, Subsidiary 6, and Subsidiary 7 (collectively, the "Active Subsidiaries"), each of which is controlled by Distributing. Subsidiary 1 owns all the stock of Sub 1, Subsidiary 2 owns all the stock of Sub 2, Subsidiary 3 owns all the stock of Sub 3, and Subsidiary 4 owns all the stock of Sub 4. Sub 1, Sub 2, Sub 3, and Sub 4 collectively are referred to as the "Investment Subsidiaries."

Distributing has two classes of common stock outstanding -- the "Class A Shares," which are voting shares for federal income tax purposes, and the "Class B Shares," which are non-voting shares for federal income tax purposes. At the time of the proposed distribution, approximately b percent of Distributing's Class A Shares will be subject to a Shareholders Agreement (the "Distributing Shareholders Agreement"). Upon termination of employment, a party to the Distributing Shareholders Agreement is required to sell all of his or her Distributing Class A Shares to (i) his or her successor-in-function, (ii) Distributing, or (iii) the remaining Class A shareholders that are subject to the Distributing Shareholders Agreement. All the parties to the Distributing Shareholders Agreement will execute an agreement with respect to dispositions of the Controlled Class A Shares (described below) that is the same as the Distributing Shareholders Agreement in all material respects (the "Controlled Shareholders Agreement").

Financial information has been submitted indicating that each of the Active Subsidiaries has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Financial information, including detailed growth projections, has been submitted indicating that the proposed distribution will enable Distributing to achieve significant cost savings by relieving Distributing of an Agency requirement that would be imposed absent the distribution. Therefore, the following transaction has been proposed:

(i) Distributing will contribute its controlling interests in Subsidiary 5, Subsidiary 6, and Subsidiary 7 to a newly formed corporation ("Controlled") solely in exchange for Class A Shares and Class B Shares of Controlled (the "Contribution"). The Class A Shares and Class B Shares of Controlled will have rights identical to the rights of Distributing's Class A Shares and Class B Shares, respectively, and will equal the number of Class A Shares and Class B Shares of Distributing, respectively, that are outstanding immediately before the distribution.

(ii) Immediately following the Contribution, Distributing will distribute all the stock of Controlled pro rata (with respect to both the Class A Shares and the Class B Shares) to its shareholders (the "Distribution"). Distributing and Controlled generally will agree to indemnify each other for certain liabilities that include (i) any indebtedness incurred under a tax sharing agreement, (ii) any indebtedness incurred under a tax matters agreement, and (iii) any indebtedness that may arise in connection with

transactions between Distributing and Controlled following the Distribution.

The following representations have been made with respect to the proposed transaction:

(a) Indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

(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 Distributing.

(c) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of stock and securities of controlled corporations (specifically, Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4) that are engaged in the active conduct of a trade or business as defined in § 355(b)(2) of the Internal Revenue Code (the "Code").

(d) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of stock and securities of controlled corporations (specifically, Subsidiary 5, Subsidiary 6, and Subsidiary 7) that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).

(e) The fair market value of each of the Active Subsidiaries' active businesses presently constitutes and will constitute at least five percent of the total fair market value of all of such corporation's gross assets. For purposes of this representation, stock owned by any of the Active Subsidiaries in Investment Subsidiaries is treated as an inactive asset.

(f) The five years of financial information submitted on behalf of each of the Active Subsidiaries is representative of each corporation's present operations, and with regard to each such corporation, there has been no substantial operational changes since the date of the last financial statements submitted.

(g) Following the Distribution, Distributing and Controlled will each continue the active conduct of Business X (indirectly through the Active Subsidiaries) independently and with its separate employees.

(h) The Distribution is to be carried out for the following corporate business purpose: cost savings. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(i) 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 Distribution. Also, any shareholder that is required to dispose of all

of its Class A Shares of Distributing pursuant to the Distributing Shareholders Agreement will be required to simultaneously dispose of all of its Class A Shares of Controlled pursuant to the Controlled Shareholders Agreement. Similarly, any shareholder that is required to dispose of all of its Class A Shares of Controlled pursuant to the Controlled Shareholders Agreement will be required to simultaneously dispose of all of its Class A Shares of Distributing pursuant to the Distributing Shareholders Agreement.

(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 through stock purchases meeting the requirements of Section 4.05(1)(b) of Rev. Proc. 96-30.

(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 the assets of either corporation after the transaction, except in the ordinary course of business.

(l) Except for any potential liabilities assumed in connection with the tax sharing agreement or the tax matters agreement, Controlled will not assume any liabilities or take any assets subject to liabilities in the Contribution.

(m) Distributing has neither accumulated its receivables nor made any extraordinary payment of its payables in anticipation of the Distribution.

(n) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution other than (i) any indebtedness incurred under a tax sharing agreement, (ii) any indebtedness incurred under a tax matters agreement, and (iii) any indebtedness that may arise in connection with transactions between Distributing and Controlled following the Distribution.

(o) No indebtedness has been or will be cancelled in connection with the transaction.

(p) 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 stock of Controlled, Subsidiary 5, Subsidiary 6, and Subsidiary 7 will be included in income immediately before the Distribution.

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

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

(s) 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 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 facts submitted and the representations made above, it is held as follows:

(1) The Contribution and the Distribution will, collectively, qualify as a "reorganization" within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).

(2) Distributing will recognize no gain or loss upon the transfer of assets to Controlled in exchange for Controlled stock and any assumption of liabilities (§§ 361(a) and 357(a)).

(3) Controlled will recognize no gain or loss on the receipt of assets in exchange for Controlled stock and any assumption of liabilities (§ 1032(a)).

(4) Controlled's basis in each asset received from Distributing will be equal to the basis of such asset in the hands of Distributing immediately prior to the transfer of assets to Controlled (§ 362(b)).

(5) Controlled's holding period for each asset received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).

(6) Distributing will recognize no gain or loss upon the distribution of Controlled to the Distributing shareholders (§§ 361(c) and 355(c)).

(7) Distributing shareholders 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)(1)).

(8) The aggregate basis of the Distributing stock and the Controlled stock held by each Distributing shareholder will equal the aggregate basis of such shareholder's Distributing 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), (b) and (c)).

(9) The holding period of the Controlled stock received by Distributing's shareholders will include the holding period of the Distributing stock with respect to which the Distribution is made, provided that such Distributing stock is held as a capital asset on

the date of the distribution (§ 1223(1)).

(10) Proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with Treas. Reg. §§ 1.312-10(a) and 1.1502-33(e).

(11) Payments made by Distributing to Controlled (or its subsidiaries) or by Controlled (or its subsidiaries) to Distributing under the tax sharing agreement and tax matters agreement (i) that have arisen or will arise for a taxable period beginning on or before and ending after the Distribution and (ii) that will not become fixed and ascertainable until after the Distribution will be treated as occurring immediately before the Distribution.

No opinion is expressed about the tax treatment of the transaction under other provisions of the Code and Income Tax Regulations or about 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.

This ruling 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 facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the 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 is being sent to your representatives.

Sincerely,

By _____
Michael J. Wilder
Senior Technician Reviewer, Branch 1
Associate Chief Counsel (Corporate)