

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:

February 12, 2004

Legend

Distributing =

Controlled =

Parent =

Member =

State X =

Date 1 =

Date 2 =

Business A =

Business B =

Rating Agency =

Y =

Z =

Dear

This letter responds to your August 8, 2003 letter requesting rulings on certain federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated October 14, October 29, and December 9, 2003, and February 11, 2004. The information submitted in such request and subsequent correspondence is summarized below.

Summary of Facts

Distributing, a wholly-owned subsidiary of Parent, was incorporated in State X on Date 1. Distributing uses the accrual method of accounting and is engaged in Business A.

Controlled, a wholly-owned subsidiary of Distributing, was incorporated in State X on Date 2. Controlled uses the accrual method of accounting and is engaged in Business B.

Distributing and Controlled are members of an affiliated group of corporations filing a consolidated federal income tax return of which Parent is the common parent. The Parent group files its federal income tax returns on a calendar year basis.

Financial information has been submitted which indicates that Distributing and Controlled each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

The Proposed Transaction

Distributing and other companies engaged in Business A are rated by Rating Agency. Improvement in the rating given by Rating Agency allows a company to more effectively compete with other companies in the industry. One of the primary factors used in the determination of the ratings is a company's liquidity. The nonliquid nature of Controlled's stock has had a negative impact on Distributing's rating. In order to increase the liquidity of Distributing's assets and thus improve Distributing's rating, the following transaction is proposed (the "Transaction"):

- (i) Controlled will borrow approximately \$Y from a commercial bank (the "Loan").

(ii) Controlled will pay a cash dividend to Distributing of approximately \$Z to Distributing.

(iii) Distributing will distribute all of the Controlled shares of stock to Parent (“the Distribution”).

(iv) Within one-year of the Distribution, Controlled will sell common stock (not to exceed 50 percent of the total number of Controlled common shares) in a private placement offering, using the proceeds to repay the Loan and to expand Business B’s operations.

Representations

The taxpayer has made the following representations concerning Distributing, Controlled, and the Transaction:

(a) No intercorporate debt will exist between Distributing and Controlled subsequent to the Distribution.

(b) No part of the consideration to be distributed by Distributing will be received by Parent as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) The five years of financial information submitted on behalf of Distributing represents its present operations, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statement submitted.

(d) The five years of financial information submitted on behalf of Controlled represents its present operations, and with regard to Controlled, there have been no substantial operational changes since the date of the last financial statement submitted.

(e) Following the Distribution, the gross assets of Business A that Distributing relies on to satisfy the active trade or business requirement of § 355(b) will have a fair market value that is equal to at least 5 percent of the total fair market value of the gross assets of Distributing.

(f) Following the Distribution, the gross assets of Business B that Controlled relies on to satisfy the active trade or business requirement of § 355(b) will have a fair market value that is equal to at least 5 percent of the total fair market value of the gross assets of Controlled.

(g) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.

(h) The Transaction will be carried out to improve Distributing's rating with Rating Agency. The Transaction is motivated, in whole or substantial part, by this corporate business purpose.

(i) There is no plan or intention by Parent 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 through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

(k) Except as described in the following paragraph, 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 Distribution, except in the ordinary course of business.

Following the Distribution, all of the assets and liabilities of Member, wholly-owned subsidiary of Parent, will be transferred to Controlled, either by merger of Member into Controlled or by contribution of Member's shares to Controlled followed by a liquidation of Member into Controlled.

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

(m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.

(n) 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. Further, Distributing's excess loss account, if any, with respect to Controlled's stock will be included in income immediately before the Distribution.

(o) 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.

(p) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 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 §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(q) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 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 §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 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 §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(r) 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 entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

Rulings

Based solely on the information submitted and representations made, we rule as follows:

(1) No gain or loss will be recognized by Distributing on the Distribution (§ 355(c)(1)).

(2) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Parent on the receipt of Controlled stock (§ 355(a)(1)).

(3) The aggregate basis of the Controlled stock in the hands of Parent after the Distribution will equal the aggregate basis of the Distributing stock held by Parent immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(b)).

(4) The holding period of the Controlled stock received by Parent will include the holding period of the Distributing stock with respect to which the Distribution is made, provided such stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(5) Distributing and Controlled will properly allocate their earnings and profits pursuant to § 1.312-10(a) of the Income Tax Regulations (§ 312(h)).

Caveats and Procedural Statements

No opinion is expressed about the tax treatment of the Transaction under other provisions 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.

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

Each taxpayer involved in this transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the transaction covered by this letter is completed.

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

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

Sincerely,

Gerald Fleming

Gerald Fleming

Senior Technician Reviewer, Branch 2

Office of Associate Chief Counsel

(Corporate)