

Internal Revenue Service

Department of the Treasury

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Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

Sub 7 =

business m =

business n =

business o =

State A =

Date B =

Property C =

Property D =

X =

Y =

Z =

This is in response to a letter dated November 18, 1999, in which rulings were requested on behalf of Distributing regarding certain federal income tax consequences of a proposed and partially completed transaction. The information submitted in that request and in letters dated January 5 and February 18, 2000, is substantially as set forth below.

Distributing is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year, accrual method basis. Distributing is a State A corporation engaged in business m, business n, and business o through its subsidiaries. Distributing has submitted, for businesses m, n and o, information representative of the active conduct of a trade or business for each of the past five years. As of Date B, Distributing had X shares of voting common stock outstanding, Y shares of Series A preferred stock authorized but not outstanding, and Z shares of preferred stock authorized but not outstanding.

Subs 1, 3, 4, 5, 6 and 7 are wholly owned subsidiaries of Distributing. Sub 2 is a wholly owned subsidiary of Sub 1. Subs 2, 3, 4, and 5 are engaged in business n. Sub 6 is engaged in business m and Sub 7 is engaged in business o.

Distributing has provided information that the operation of business m and business n within the same controlled group of corporations has given rise to substantial difficulties. Separation of business m and business n will allow each business to pursue its strategic business plan and operate more efficiently.

Accordingly, the following transaction is proposed (and has been partially completed):

(1) Distributing will transfer a portion of an intercompany note receivable from Sub 1 to Sub 6.

(2) Sub 1 will transfer Property D to Sub 6 in satisfaction of the intercompany note receivable.

(3) Distributing will transfer Property C to Sub 6.

(4) Distributing will cause Sub 1 to merge with and into Distributing (the "Liquidation").

(5) Distributing will form Controlled and transfer the stock of Sub 2, Sub 3, Sub 4, and Sub 5, all of which is common stock, to Controlled in constructive exchange for additional shares of Controlled stock (the "First Transfer"). No liabilities will be assumed or property transferred subject to liabilities.

(6) Controlled will transfer the stock of Subs 4 and 5 to Sub 2 in constructive exchange for Sub 2 stock (the "Second Transfer"). No liabilities will be assumed or property transferred subject to liabilities.

(7) Distributing will distribute all of the Controlled stock pro rata to its shareholders (the "Distribution").

The taxpayers have made the following representations in connection with the Liquidation:

- (a) Distributing on the date of adoption of the plan of complete liquidation, and at all times until the final liquidating distribution is completed, will be the owner of at least 80 percent of the single outstanding class of stock of Sub 1.
- (b) No shares of Sub 1 stock will have been redeemed during the three years preceding the adoption of the plan of complete liquidation of Sub 1.
- (c) Distributions from Sub 1 to Distributing pursuant to the plan of complete liquidation will be made within a single taxable year of Sub 1.
- (d) As soon as the first liquidating distribution has been made, Sub 1 will cease to be a going concern and its activities will be limited to winding up its affairs, paying its debts, and distributing its remaining assets to its shareholders.
- (e) Sub 1 will retain no assets following the final liquidating distribution.
- (f) Sub 1 will not have acquired assets in any nontaxable transactions at any time, except for acquisitions occurring more than three years prior to the date of adoption of the plan of liquidation.
- (g) No assets of Sub 1 have been, or will be, disposed of by either Sub 1 or

Distributing except for dispositions in the ordinary course of business and dispositions occurring more than three years prior to the adoption of the plan of complete liquidation, except as described in step (2) above.

- (h) Prior to the adoption of the liquidation plan, no assets of Sub 1 will have been distributed in kind, transferred, or sold to Distributing, except for transactions occurring in the ordinary course of business and transactions occurring more than three years prior to adoption of the liquidation plan.
- (i) Sub 1 does not hold, and will not hold at the time of the liquidation, any assets representing earned but unreported income.
- (j) The fair market value of the assets of Sub 1 will exceed its liabilities both at the date of the adoption of the plan of complete liquidation and immediately prior to the time the first liquidating distribution is made.
- (k) On the date of the distribution, there will be no intercorporate debt existing between Distributing and Sub 1, and none has been canceled, forgiven, or discounted, except for the intercompany account balance and transactions that occurred more than three years prior to the date of adoption of the liquidation plan.
- (l) Distributing is not an organization that is exempt from federal income tax under § 501 or any other provision of the Code.
- (m) All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the proposed liquidation of Sub 1 have been fully disclosed.

The taxpayers have made the following representations in connection with the First Transfer:

- (n) No stock or securities will be issued for services rendered to or for the benefit of Controlled in connection with the transaction; and no stock or securities were issued for indebtedness of Controlled that was not evidenced by a security or for interest on indebtedness of Controlled which accrued on or after the beginning of the holding period of Distributing for the debt.
- (o) The First Transfer is not the result of a solicitation by a promoter, broker, or investment house.
- (p) Distributing will not retain any rights in the property transferred to Controlled.
- (q) There will be no indebtedness between Distributing and Controlled, and no

indebtedness will be created in favor of Distributing as a result of the First Transfer.

- (r) The transfers and exchanges will occur under a plan agreed upon before the First Transfer in which the rights of the parties are defined.
- (s) All exchanges will occur on approximately the same date.
- (t) There is no plan or intention on the part of Controlled to redeem or otherwise acquire any stock or indebtedness that will be issued in the First Transfer.
- (u) 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 in the exchange, Distributing or its shareholders will be in "control" of Controlled within the meaning of § 368(c) of the Code.
- (v) Distributing will constructively receive Controlled stock approximately equal to the fair market value of the assets transferred to Controlled.
- (w) There is no plan or intention by Controlled to dispose of the transferred property other than pursuant to the Second Transfer or in the normal course of business operations.
- (x) Distributing and Controlled will each pay its own expenses, if any, incurred in connection with the First Transfer.
- (y) Controlled will not be an investment company within the meaning of § 351(e)(1) and § 1.351-1(c)(1)(ii).
- (z) 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 or securities received in the exchange will not be used to satisfy the indebtedness of such debtor.
- (aa) Controlled will not be a "personal service corporation" within the meaning of § 269A.

The taxpayers have made the following representations in connection with the Second Transfer:

- (bb) No stock or securities will be issued for services rendered to or for the benefit of Sub 2 in connection with the transaction; and no stock or securities were issued for indebtedness of Sub 2 that was not evidenced by a security or for interest on

- indebtedness of Sub 2 which accrued on or after the beginning of the holding period of Controlled for the debt.
- (cc) The Second Transfer is not the result of a solicitation by a promoter, broker, or investment house.
 - (dd) Controlled will not retain any rights in the property transferred to Sub 2.
 - (ee) There will be no indebtedness between Controlled and Sub 2, and no indebtedness will be created in favor of Controlled as a result of the Second Transfer.
 - (ff) The transfers and exchanges will occur under a plan agreed upon before the Second Transfer in which the rights of the parties are defined.
 - (gg) All exchanges will occur on approximately the same date.
 - (hh) There is no plan or intention on the part of Sub 2 to redeem or otherwise acquire any stock or indebtedness that will be issued in the Second Transfer.
 - (ii) Taking into account any issuance of additional shares of Sub 2 stock; any issuance of stock for services; the exercise of any Sub 2 stock rights, warrants, or subscriptions; a public offering of Sub 2 stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of Sub 2 to be received in the exchange, Controlled will be in "control" of Sub 2 within the meaning of § 368(c) of the Code.
 - (jj) Controlled will constructively receive Sub 2 stock approximately equal to the fair market value of the assets transferred to Sub 2.
 - (kk) There is no plan or intention by Sub 2 to dispose of the transferred property other than in the normal course of business operations.
 - (ll) Controlled and Sub 2 will each pay its own expenses, if any, incurred in connection with the Second Transfer.
 - (mm) Sub 2 will not be an investment company within the meaning of § 351(e)(1) and § 1.351-1(c)(1)(ii).
 - (nn) Controlled 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 or securities received in the exchange will not be used to satisfy the indebtedness of such debtor.
 - (oo) Sub 2 will not be a "personal service corporation" within the meaning of § 269A.

The taxpayers have made the following representations in connection with the Distribution:

- (pp) Any indebtedness owed by Controlled to Distributing or any other related party after the Distribution will not constitute stock or securities for federal income tax purposes.
- (qq) No part of the consideration 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.
- (rr) The five years of financial information submitted on behalf of Sub 2, Sub 3, Sub 6, and Sub 7 is representative of each corporation's present operation, and with regard to each corporation, there has not been any substantial operational changes since the date of the last financial statement submitted.
- (ss) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock of Sub 6 and Sub 7.
- (tt) Immediately after the Distribution, the gross assets of Sub 6's and Sub 7's active trade or business (as defined in § 355(b)(2)) will have a fair market value equal to at least 5 percent of the total fair market value of the gross assets of Sub 6 and Sub 7, respectively.
- (uu) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of the stock of Sub 2 and Sub 3.
- (vv) Immediately after the Distribution, the gross assets of Sub 2's and Sub 3's active trade or business (as defined in § 355(b)(2)) will have a fair market value equal to at least 5 percent of the total fair market value of the gross assets of Sub 2 and Sub 3, respectively.
- (ww) Following the Distribution, Sub 2, Sub 3, Sub 6, and Sub 7 will each continue the active conduct of its business, independently and with its separate employees.
- (xx) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to alleviate difficulties that exist in operating both business m and business n within the same controlled group of corporations and facilitate the successful growth and development of each. The distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (yy) There is no plan or intention by any shareholder who owns 5 percent or more of the stock of Distributing, and the management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular

remaining shareholder or security holder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the transaction.

- (zz) 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 stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (aaa) 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.
- (bbb) No intercorporate debt will exist between Distributing or any related party, on the one hand, and Controlled or any related party, on the other hand, at the time of or after the distribution.
- (ccc) 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, there will be no excess loss account in respect of any stock of Distributing, Controlled or any direct or indirect subsidiary thereof, immediately before the distribution.
- (ddd) Payments made in connection with all continuing transactions between Distributing or any related party, on one hand, and Controlled or any related party, on the other hand, will be for fair market value and based on terms and conditions arrived at by the parties bargaining at arms' length.
- (eee) No investment credit determined under § 46 has been (or will be) claimed with respect to property transferred to Controlled.
- (fff) No two parties to the proposed transaction are investment companies as defined in §§ 368(a)(2)(F)(iii) and (iv).
- (ggg) 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 or at least 50 percent of the total value of shares 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) The Liquidation will qualify as a complete liquidation of Sub 1 within the meaning of § 332.

(2) No gain or loss will be recognized by Distributing on receiving the assets and liabilities of Sub 1 in the Liquidation (§ 332(a)).

(3) No gain or loss will be recognized by Sub 1 on the distribution of its assets to, or the assumption of its liabilities by, Distributing (§§ 336(d)(3), 337(a), and 337(b)).

(4) Distributing's basis in each asset received from Sub 1 as a result of the Liquidation will equal the basis of that asset in the hands of Sub 1 immediately before the Liquidation (§ 334(b)(1)).

(5) Distributing's holding period in each asset received from Sub 1 as a result of the Liquidation will include the period during which that asset was held by Sub 1 (§ 1223(2)).

(6) Distributing will succeed to and take into account the items of Sub 1 described in § 381(c), subject to the conditions and limitations specified in §§ 381, 382, 383, and 384 and the regulations thereunder (§§ 381(a) and 1.381(a)(1)).

(7) Except to the extent Sub 1's earnings and profits are reflected in Distributing's earnings and profits, Distributing will succeed to and take into account the earnings and profits, or deficit in earnings and profits, of Sub 1 as of the date of the Liquidation (§§ 381(c)(2)(A), 1.381(c)(2)(1), and 1.1502-33(a)(2)). Any deficit in the earnings and profits of Sub 1 or Distributing will be used only to offset earnings and profits accumulated after the date of the Liquidation (§ 381(c)(2)(B)).

(8) No gain or loss will be recognized by Distributing in the First Transfer (§ 351(a)).

(9) No gain or loss will be recognized by Controlled in the First Transfer (§ 1032(a)).

(10) The basis of each asset received by Controlled in the First Transfer will equal the basis of that asset in the hands of Distributing immediately before the Transfer (§ 362(a)(1)).

(11) The holding period of each asset received by Controlled in the First Transfer will include the holding period of that asset in the hands of Distributing (§ 1223(2)).

(12) No gain or loss will be recognized by Controlled in the Second Transfer (§ 351(a)).

(13) No gain or loss will be recognized by Sub 2 in the Second Transfer (§ 1032(a)).

(14) The basis of each asset received by Sub 2 in the Second Transfer will equal the basis of that asset in the hands of Controlled immediately before the Second Transfer (§ 362(a)(1)).

(15) The holding period of each asset received by Sub 2 in the Second Transfer will include the holding period of that asset in the hands of Controlled (§ 1223(2)).

(16) Controlled's basis in its Sub 2 stock will be increased by Controlled's basis in the Sub 4 and Sub 5 stock immediately before the Second Transfer (§§ 358(a)).

(17) No gain or loss will be recognized by Distributing upon the distribution of its Controlled stock (§ 355(c)).

(18) No gain or loss will be recognized by Distributing shareholders (and no amount will be included in their income) upon receipt of Controlled stock (§ 355(a)(1)).

(19) The aggregate basis of the Distributing stock and the Controlled stock in the hands of the Distributing shareholders after the Distribution will be the same as the aggregate basis of the Distributing stock held immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§§ 358(a), (b), and (c)).

(20) The holding period of the Controlled stock in the hands of the Distributing shareholders will include the period for which such shareholder held the Distributing stock, provided that such stock was held as a capital asset by such shareholder on the date of distribution (§ 1223(1)).

(21) Proper allocation of earnings and profits between Distributing and Controlled will be made under §§ 1.312-10(b) and 1.1502-33.

No opinion is expressed about the tax treatment of steps 1, 2, or 3; nor is any opinion expressed about the proposed and partially completed 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 transaction that are not specifically covered by the above rulings. Specifically, no opinion is expressed as to the treatment of any of the above transactions under § 1.1502-13.

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

Pursuant to a power of attorney on file in this office, a copy of this letter has been

sent to your authorized representative.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By *Ken Cohen*

Ken Cohen

Senior Technical Reviewer, Branch 3