

Internal Revenue Service

Department of the Treasury

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Refer Reply To:
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Date:
May 8, 2001

Legend

Distributing =

Controlled =

Sub #1 =

Business A =

Business B =

State X =

a =

b =

Dear

This is in response to your letter dated October 30, 2000, requesting rulings on behalf of Distributing with respect to a proposed and partly consummated transaction. Additional information was received in letters dated January 8, 2001, January 24, 2001, February 28, 2001, March 27, 2001, April 27, 2001, and May 4, 2001. The material information submitted is summarized below.

Distributing is a publicly traded State X corporation engaged directly and through subsidiaries including Sub #1, a wholly owned first-tier subsidiary of Distributing, in Business A and Business B. Distributing is the common parent of an affiliated group of corporations filing a consolidated return on the basis of a fiscal year ending September 30.

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Immediately prior to the distribution of the Controlled stock as described below, Distributing will have outstanding approximately a shares of common stock and b shares of preferred stock. Each outstanding share of Distributing common stock also evidences one preferred share purchase right, that is, a right to purchase a fraction of a share of Distributing preferred stock upon the occurrence of certain specified triggering events.

Financial information has been received indicating that Business A and Business B have each had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five fiscal years.

In order to allow management of each of Business A and Business B to focus solely on the opportunities and challenges specific to that business, including the adoption of capital structures and resource allocation policies that reflect the financial and strategic characteristics of each business, the following series of transactions is proposed:

1. Distributing will form a subsidiary corporation, Controlled.
2. Sub #1, which is engaged in both Business A and Business B, will liquidate, distributing all its assets to Distributing (the "Liquidation").
4. Distributing will contribute its Business B assets, including the Business B assets of Sub #1 and the stock of certain corporations engaged in Business B, to Controlled (the "Contribution").
5. Distributing will distribute its Controlled stock pro rata to the Distributing shareholders (the "Distribution").

Distributing has two issues of outstanding long-term debt (the "Convertible Notes"). In accordance with the terms of the Convertible Notes, Controlled will assume liability for these obligations and they will become convertible into Controlled stock.

It is expected that each share of Controlled stock will evidence one preferred Share Purchase Right, the terms of which are expected to be substantially the same as those of the Distributing share purchase rights described above.

It is not anticipated that there will be any continuing transactions between Distributing and Controlled following the Distribution, other than possible transactions in the ordinary course of business or pursuant to certain short-term transitional agreements including a tax sharing agreement.

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

- (a) Distributing will, on the date of adoption of the plan of complete liquidation, and at all times until the final distribution is completed, be the

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- owner of at least 80% of the single outstanding class of the 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.
 - (e) Sub #1 will not have acquired assets in any nontaxable transaction at any time, except for acquisitions occurring more than three years prior to the date of adoption of the plan of liquidation.
 - (f) No assets of Sub #1 have been, or will be, disposed of by either Distributing or Sub #1 except for dispositions in the ordinary course of business and dispositions occurring more than three years prior to adoption of the plan of liquidation, except for Business B assets held by Sub #1 (including certain stock), which following the liquidation, will be contributed to Controlled.
 - (g) The liquidation of Sub #1 will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation of any of the businesses or assets of Sub #1, if persons holding, directly or indirectly, more than 20% in value of the Sub #1 stock also hold, directly or indirectly, more than 20% in value of the stock in the recipient corporation. For purposes of this representation, ownership will be determined immediately after the spin-off and by application of the constructive ownership rules of § 318(a) of the Code as modified by § 304(c)(3).
 - (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 the adoption of the liquidation plan.
 - (i) Sub #1 will report all earned income represented by assets that will be distributed to its shareholders such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.

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- (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) There is no intercorporate debt existing between Distributing and Sub #1 and none has been canceled, forgiven, or discounted, except for 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 following representations have been made in connection with the Contribution and the Distribution:

- (n) Cash is being distributed in lieu of fractional shares of Controlled. The payment of cash in lieu of fractional shares of Controlled is solely for the purposes of avoiding the expense and inconvenience to Controlled of issuing fractional shares and does not represent separately bargained-for consideration. The method used for handling fractional share interests is designed to limit the amount of cash received by any one shareholder to less than the value of one full share of Controlled common stock.
- (o) 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.
- (p) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (q) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (r) The distribution of the Controlled stock is carried out for the following business purpose: to better enable Distributing and Controlled to manage, operate, and develop more efficiently their respective businesses. The Distribution is motivated, in whole or substantial part, by this corporate business purposes.

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- (s) There is no plan or intention by any shareholder who owns 5% or more 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.
- (t) There is no plan or intention by 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.
- (u) There is no plan or intention to liquidate 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.
- (v) For purposes of §355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50% of more of the total combined voting power of all classes of Distributing or Controlled stock entitled to vote, or 50% or more of the total value of shares of all classes of Distributing or Controlled 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.
- (w) 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 either Distributing or Controlled stock entitled to vote, or stock possessing 50% or more of the total value of all classes of stock of either Distributing or Controlled.
- (x) The total adjusted bases and the fair market value of the assets to be transferred by Distributing to Controlled each equals or exceeds the sum of the liabilities (if any) assumed by Controlled plus any liabilities to which the transferred assets are subject; and the liabilities assumed in the transaction and to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (y) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transactions described above.
- (z) Except with respect to any future obligations arising out of the continuing relations described above, no intercorporate debt will exist between

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Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock. If any indebtedness is owed by Controlled to Distributing after the distribution of the Controlled stock, such indebtedness will not constitute stock or securities.

- (aa) 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 common stock will be included in income immediately before the Distribution (see § 1.1502-19).
- (bb) Payments made in connection with all continuing transactions (except under the tax sharing agreement), 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.
- (cc) If the Controlled Share Purchase Rights are attached to Controlled common stock in the Distribution, such rights will not be traded apart from the Controlled common stock before the occurrence of certain triggering events. Before the occurrence of such events, the Share Purchase Rights may be redeemed by Controlled. At the time the Controlled common stock is issued to Distributing, and at the time of the Distribution, the likelihood that the Controlled Share Purchase Rights would be exercised will be both remote and uncertain.

Based solely on the information submitted and the representations made, we have concluded with respect to the Liquidation that:

- (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 the receipt of the assets and liabilities of Sub #1 in the Liquidation. Section 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. Sections 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. Section 334(b).

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- (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. Section 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 §§ 382, 383, 384, and the regulations thereunder. Section 381(a) and § 1.381(a)-1 of the Regulations.
- (7) Except to the extent that 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. Sections 381(c)(2)(A) and §§ 1.381(c)(2)-1 and 1.1502-33(a)(2) of the Regulations. Any deficit in earnings and profits of Sub #1 or Distributing will be used only to offset earnings and profits accumulated after the date of the liquidation. Section 381(c)(2)(B).

Based solely on the information submitted and the representations made, we have concluded with respect to the Contribution and Distribution that:

- (8) The transfer by Distributing to Controlled of the assets as described above, followed by the Distribution is a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be a "party to the reorganization" within the meaning of § 368(b).
- (9) No gain or loss will be recognized by Distributing upon the transfer of its Business B assets, including certain stock, to Controlled in exchange or constructive exchange for Controlled stock and the assumption by Controlled of certain liabilities. Sections 361(a) and (b) and 357(a).
- (10) Controlled's assumption of Distributing's obligation in connection with the plan of reorganization to issue Distributing stock upon conversion of the Convertible Notes will be treated as an assumption of Distributing's liabilities for purposes of § 357. No gain or loss will be recognized by Distributing or Controlled in respect of the issuance of Controlled stock issued upon conversion of the Convertible Notes. Section 1032.
- (11) No gain or loss will be recognized by Controlled on the receipt of the assets described above in exchange for Controlled stock. Section 1032(a).
- (12) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the exchange described above increased by the gain, if any, recognized by Distributing. Section 362(b).

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- (13) The holding period of each asset received by Controlled will include the period during which such asset was held by Distributing before the Contribution. Section 1223(2).
- (14) No gain or loss will be recognized by Distributing upon the distribution of all the Controlled stock to the Distributing shareholders. Section 361(c)(1).
- (15) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders upon receipt of the Controlled stock. Section 355(a)(1).
- (16) The aggregate basis of the Distributing and the Controlled stock in the hands of the Distributing shareholders immediately after the Distribution will be the same as the aggregate basis of the Distributing stock held by the Distributing shareholders immediately before the Distribution, allocated in accordance with § 1.358-2(a)(2) of the Regulations. Section 358(c).
- (17) The holding period of the Controlled stock received by the Distributing shareholders will include the holding period of the Distributing stock with respect to which the Distribution is made, provided that the Distributing stock is held as a capital asset on the date of Distribution. Section 1223(1).
- (18) The payment of cash in lieu of fractional share interests in Controlled will be treated for federal income tax purposes as if the fractional shares were issued as part of the exchange and then were redeemed by Controlled. The cash payments will be treated as having been received as distributions in full payment in exchange for the stock redeemed as provided in § 302(a). Provided that the fractional share interest is a capital asset in the hands of the exchanging shareholder, the gain or loss will constitute capital gain or loss subject to the provisions and limitations of §§ 1221 and 1222.
- (19) Provided that, at the time of the Distribution, the Share Purchase Rights remain contingent, non-exercisable, and subject to redemption if issued, the receipt of these rights by Distributing or its shareholders will not be a distribution or receipt of property, an exchange of stock or property (either taxable or nontaxable), or any other event giving rise to the realization of gross income by Distributing, Controlled, or the Distributing shareholders. Rev. Rul. 90-11, 1990-1 C.B. 10.
- (20) Proper allocation of earnings and profits will be made between Distributing and Controlled under § 312-10(a) of the Regulations. Section 312(h).

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- (21) Payments made by Distributing to Controlled or by Controlled to Distributing under the tax sharing 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. See Arrowsmith v. Commissioner, 344 U.S. 6 (1952)

No opinion is expressed as to the tax treatment of the transactions under other provisions of the Code or Regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above ruling.

In accordance with a power of attorney on file in this office, copies of this letter are being sent to your authorized representatives.

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.

Sincerely yours,
Associate Chief Counsel (Corporate)
By Charles M. Levy
Reviewer, Branch 2 (Corporate)