

## Internal Revenue Service

Department of the Treasury

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P =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Target =

Distributing =

Controlled =

Business A =

Business B =

Business C =

a =

b =

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c =

d =

e =

f =

Country X =

Country Y =

Date Y =

Dear :

This letter responds to your November 2, 2001 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in this request and in subsequent correspondence is summarized below.

P is a publicly traded domestic corporation and is the common parent of an affiliated group of corporations.

Sub 1 and Sub 4 are wholly owned domestic subsidiaries of P. Sub 2 is a wholly owned domestic subsidiary of Sub 1. Sub 3 is a wholly owned foreign subsidiary of Sub 2. Sub 5 is a wholly owned Country Y subsidiary of Sub 4.

Target is a Country X corporation that is a percent owned by Sub 2 and b percent owned by Sub 3. Target is engaged in Business C.

Distributing is a Country X corporation that is c percent owned by P and d percent owned by Sub 5. Distributing is engaged in Business A.

Controlled is a Country X corporation that is e percent owned by Distributing and f percent owned by P. Controlled is engaged in Business B.

Financial information has been submitted which indicates that each of Business A and Business B has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the last 5 years.

According to taxpayer's submission, along with supporting documentation, the separation of Distributing and Controlled would positively affect the operations of Controlled. Controlled has experienced significant systemic problems by operating as a subsidiary of Distributing. Eliminating the parent subsidiary relationship would allow Controlled to focus on Business B without inefficiencies brought on by the oversight,

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required by Country X law, by Distributing.

Accordingly, the following transaction is proposed:

(i) Sub 3 will merge with and into Sub 5, with Sub 5 surviving. As a result, Sub 5 will become the owner of b percent of Target. In the merger, Sub 5 stock will be issued to Sub 2. Such stock will be distributed to Sub 1, which will distribute it to P. P will contribute it to Sub 4.

(ii) Distributing's interest in Controlled will be transferred to a newly formed Country X corporation [redacted] will have no assets or liabilities other than the Controlled stock and it will be owned by the same entities and in the same proportions as Distributing is owned.

(iii) Controlled will merge with and into [redacted] with Controlled surviving the merger. Immediately after the merger, Controlled will be owned c percent by P and d percent by Sub 5.

(iv) For what are represented to be valid business reasons, Target will merge with and into Controlled, with Controlled surviving. All of the assets of Target will be transferred to, and all of Target's liabilities will be assumed by, Controlled. Sub 2's and Sub 5's shares in Target will be converted into Controlled shares on a fair market value basis. Sub 2 will distribute the Controlled shares it receives in the merger to Sub 1, which will distribute such shares to P.

As of Date Y, Target and Controlled entered into a "business lease" agreement. Pursuant to the lease Controlled makes quarterly fair market value lease payments to Target for the right to operate Target's business and to utilize Target's assets and employees for this purpose. The lease arrangement will terminate when Target merges into Controlled.

In connection with the proposed transaction set forth in steps (ii) and (iii) set forth above, it has been represented that:

- (a) There is no plan or intention to liquidate either Distributing or Controlled, to merge either into 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.
- (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 5 years of financial information submitted on behalf of Business A is representative of its present operations, and with regard to such business,

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there have been no substantial operational changes since the date of the last financial statements submitted.

- (d) The 5 years of financial information submitted on behalf of Business B is representative of its present operations, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (f) Immediately after the distribution, the gross assets of Business A conducted by Distributing will have a fair market value equal to at least 5 percent of the total fair market value of the gross assets of Distributing.
- (g) Immediately after the distribution, the gross assets of Business B conducted by Controlled will have a fair market value equal to at least 5 percent of the total fair market value of the gross assets of Controlled.
- (h) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the distribution.
- (i) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any its outstanding stock after the distribution, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (k) 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.
- (l) None of Distributing, Controlled or Target is an investment company as defined in § 368(a)(2)(F)(iii) and (iv) of the Internal Revenue Code.
- (m) 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 (other than as a result of the distribution), directly or indirectly, stock possessing 50 percent or greater interest (as defined in § 355(e)(4)(A)) in either Distributing or Controlled.

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- (n) Immediately after the distribution no person will hold, directly or indirectly, disqualified stock, within the meaning of § 355(d), in Distributing or Controlled that constitutes a 50 percent or greater interest in Distributing or Controlled.
- (o) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to eliminate inefficiencies caused by the parent-subsidiary relationship between Distributing and Controlled. The distribution of the stock of Controlled is motivated in whole or substantial part by this corporate business purpose.

In connection with the proposed transaction set forth in step (iv) above, it has been represented that:

- (a) Aside from the proposed distribution of Controlled stock by Sub 2 to Sub 1, and the proposed distribution of Controlled stock by Sub 1 to P, there is no plan or intention for Sub 1, Sub 2, P, or Sub 5 to sell or otherwise dispose of any of the shares of Controlled.
- (b) The fair market value of the Controlled stock and other consideration received by each Target shareholder will be approximately equal to the fair market value of the Target stock surrendered in the exchange.
- (c) Controlled will acquire at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Target immediately prior to the transaction. For purposes of this representation, amount paid by Target to shareholders who receive cash or other property, amounts used by Target to pay its reorganization expenses, and all redemptions and distributions (except for regular, normal dividends) made by Target immediately preceding the transfer will be included as assets of Target held immediately prior to the transaction.
- (d) After the transaction, the shareholders of Target will be in control of Controlled within the meaning of § 368(a)(2)(H).
- (e) Controlled has no plan or intention to reacquire any of its stock issued in the transaction.
- (f) Controlled has no plan or intention to sell or otherwise dispose of any of the assets of Target acquired in the transaction, except for dispositions made in the ordinary course of business.
- (g) The liabilities of Target assumed (as determined under § 357(d)) by Controlled were incurred by Target in the ordinary course of its business and are associated with the assets transferred.

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- (h) Following the transaction, Controlled will continue the historic business of Target or use a significant portion of Target's historic business assets in a business.
- (i) At the time of the transaction, Controlled will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Controlled that, if exercised or converted, would effect the Target shareholders' acquisition or retention of control of Controlled, as defined in § 368(a)(2)(H).
- (j) Controlled, Target, and the shareholders of Target will pay their respective expenses, if any, incurred in connection with the transaction.
- (k) There is no intercorporate indebtedness existing between Controlled and Target that was issued, acquired, or will be settled at a discount.
- (l) Neither Controlled nor Target is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).
- (m) Each of the total adjusted basis and the fair market value of the assets of Target transferred to Controlled will equal or exceed the sum of the liabilities to be assumed (as determined under § 357(d)) by Controlled.
- (n) Target is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

Additional representations have been made by the taxpayer with respect to steps (ii) and (iii) of the proposed transaction, as follows:

- (a) Both Distributing and Controlled are foreign corporations and are controlled foreign corporations ("CFCs"), as defined in § 957, immediately before the proposed transaction. Both Distributing and Controlled will be CFCs immediately after the proposed transaction.
- (b) Neither Distributing nor Controlled has been a United States real property holding company (a "USRPHC"), as defined in § 897(c)(2), at any time during the 5-year period ending on the date of the proposed transaction, and neither Distributing nor Controlled will be a USRPHC immediately after the proposed transaction.
- (c) Neither Distributing nor Controlled will be a passive foreign investment company before or after the proposed transaction.
- (d) Following the proposed transaction, P and Sub 5 will compute their pre-

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distribution and post-distribution amount with respect to Distributing and Controlled, as defined under § 1.367(b)-5(e)(1) and (2) of the Income Tax Regulations. To the extent their pre-distribution amount exceeds their post-distribution amount with respect to either Distributing or Controlled, P and Sub 5 will make basis adjustments or recognize income, as required under the applicable Treasury regulations.

Based solely on the information submitted and the representations set forth above, it is held as follows:

- (1) For federal income tax purposes, the proposed transaction set forth in steps (ii) and (iii), above, will be viewed as a distribution by Distributing of its e percent stock ownership in Controlled to its shareholders, Sub 5 and P.
- (2) Distributing will recognize no gain or loss on the distribution of Controlled stock to Distributing shareholders (§ 361(c)(1)).
- (3) The shareholders of Distributing will recognize no gain or loss (and no amount will be included in their income) upon the receipt of Controlled stock (§ 355(a)(1)).
- (4) The aggregate basis of the Controlled stock and Distributing stock in the hands of the shareholders of Distributing immediately after the distribution will, in each instance, be the same as the aggregate basis of the Distributing stock held immediately prior to the distribution, allocated in proportion to the fair market value of each, in accordance with § 1.358-2(a)(2) of the Income Tax Regulations (§ 358(b)).
- (5) The holding period of the Controlled stock to be received by the shareholders of Distributing will include the holding period of the Distributing stock with respect to which the distribution will be made, provided that such stock is held as a capital asset on the date of the distribution (§ 1223(1)).
- (6) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(b).
- (7) The transfer by Target of substantially all of its assets to Controlled in exchange for Controlled stock and the assumption by Controlled of the liabilities, if any, of Target, followed by the distribution by Target, of the Controlled stock to Sub 2 and Sub 5 in complete liquidation of Target will constitute a reorganization within the meaning of § 348(a)((1)(D)). Controlled and Target will each be "a party to a reorganization" within the meaning of § 368(b). For purposes of this ruling, "substantially all" means

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at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Target immediately prior to the transaction.

- (8) No gain or loss will be recognized by Target upon the transfer of substantially all of its assets to Controlled in exchange for Controlled stock and the assumption by Newco of the Target liabilities, if any (§§ 361(a) and 357(a)).
- (9) No gain or loss will be recognized by Target upon the distribution of Controlled stock to Sub 2 and Sub 5 in exchange for Target stock (§ 361(c)(1)).
- (10) No gain or loss will be recognized by Controlled upon the receipt of the assets of Target in exchange for Controlled stock (§ 1032(a)).
- (11) The basis of the assets of Target in the hands of Controlled will be the same as the basis of those assets in the hands of Target immediately prior to the transfer (§ 362(b)).
- (12) The holding period of the assets of Target acquired by Controlled will include the period during which those assets were held by Target (§ 1223(2)).
- (13) No gain or loss will be recognized by Sub 2 and Sub 5 upon the receipt of the Controlled stock in exchange for Target stock (§ 354(a)(1)).
- (14) The basis of the shares of Controlled stock received by Sub 2 and Sub 5 will be the same as the basis of the Target stock surrendered in exchange therefor (§ 358(a)(1)).

No opinion is expressed or implied concerning the tax consequences of any aspect of the transaction or item not discussed or referenced in the letter. Specifically, no opinion is expressed regarding whether any or all of the above referenced foreign corporations are passive foreign investment companies (within the meaning of § 1297(a)). If it is determined that any of the foreign corporations are passive foreign investment corporations, no opinion is expressed with respect to the application of § 1291 through § 1298 to the proposed transaction. In particular, in a transaction in which gain is not otherwise recognized, regulations under § 1291(f) may require gain recognition notwithstanding any other provision of the Code.

In addition, no opinion is expressed or implied regarding (1) the application of § 367(b) to the merger of Sub 3 into Sub 5 (see § 1.367(b)-4) and the application of §§ 367(b) and 1248 to the subsequent distribution of the Sub 5 stock by Sub 2 to Sub 1 and then by Sub 1 to P; (2) the possible income inclusion and basis reduction that may

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occur because of the application of § 1.367(b)-5(c) to steps (ii) and (iii) of the proposed transaction; and (3) the application of § 367(b) to the merger of Target into Controlled (see § 1.367(b)-4) and the application of §§ 367(b) and 1248 to the subsequent distribution of the Controlled stock by Sub 2 to Sub 1 and then by Sub 1 to P.

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 consummated.

A copy of this letter has been sent to the taxpayer's authorized representative.

Sincerely,  
Debra Carlisle  
Chief, Branch 5  
Office of Associate Chief Counsel  
(Corporate)

cc: