

## Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

December 2, 1999

Parent =

Distributing =

Controlled =

Holding =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

Industry AB =

Business A =

Business B =

State C =

Statute =

D Contracts =

E Agreement =

F Contracts =

Date G =

Date H =

Corp J =

We respond to your July 30, 1999 request for rulings on certain federal income tax consequences of a proposed transaction.

### **Facts**

Parent is the publicly held parent of a consolidated group whose subsidiaries are engaged primarily in Industry AB. Distributing, a wholly owned subsidiary of Parent, conducts Business A and Business B, which are within Industry AB. Parent's other wholly owned subsidiaries include Sub 2, also engaged in Industry AB, Sub 3, which provides administrative and other services to affiliates of Parent, and Sub 4, which markets the Business A product. Sub 5 is a wholly owned subsidiary of Sub 2 that has contracted to purchase assets used in Business A.

We have received financial information indicating that Business A and Business B, as operated by Distributing, each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

### **Business Purpose**

State C, where Distributing conducts business, has changed its laws relating to Industry AB by enacting the Statute. Under prior State C law, both Business A and Business B were regional monopolies regulated by the state. Under the Statute, Business B will remain a regulated regional monopoly, but Business A will be opened to competition. Parent and Distributing believe that separating Business A from Business B is necessary to avoid management problems arising from operating regulated and unregulated businesses in the same corporation.

### **Proposed Transaction**

To accomplish the separation, the taxpayer proposes the following transaction:

- (i) Parent will transfer assets to newly formed Holding in exchange for all of the

Holding stock.

(ii) Sub 5 will transfer certain Business A assets to Holding, subject to liabilities associated with those assets.

(iii) Distributing will transfer its Business A assets (including the D contracts and its rights and obligations under the E Agreement) to newly formed Controlled in exchange for Controlled stock and a promissory note payable by Controlled to Distributing (the "Contribution").

(iv) Distributing will distribute the stock of Controlled to Parent (the "Distribution").

(v) Parent will transfer the Controlled stock to Holding.

(vi) Holding will transfer the Business A assets it received from Sub 5 to Controlled, subject to liabilities associated with those assets.

(vii) Holding will either (a) transfer assets to newly formed Sub 6 in exchange for Sub 6 stock or (b) receive a contribution of the Sub 4 stock from Parent and transfer assets to Sub 4. Distributing will assign the F contracts to Sub 4 or Sub 6.

### **Representations**

The parties have submitted the following representations in connection with the proposed transaction:

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

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

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

(d) Following the transaction, Distributing and Controlled each will continue the active conduct of its business, independently and with its separate employees, except that they will share the services of Sub 3 employees, who will provide administrative and other services to both corporations at cost.

(e) The Distribution is motivated, in whole or substantial part, by the corporate business purpose of reducing management problems relating to the operation of regulated and unregulated businesses in the same corporation.

(f) There is no plan or intention by Parent to sell, exchange, transfer by gift, or otherwise dispose of any Distributing, Controlled, or Holding stock after the transaction, other than to transfer of the Controlled stock to Holding immediately after the Distribution.

(g) 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, 1996-1 C.B. 696, 705.

(h) 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.

(i) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing will equal or exceed the amount of the liabilities assumed (as determined under § 357(d) of the Internal Revenue Code) by Controlled.

(j) The liabilities assumed (as determined under § 357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.

(k) 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, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597).

(l) After the Distribution, Controlled will sell its product to Sub 4 (or Sub 6) at cost. Sub 4 (or Sub 6) then will sell that product to Distributing and others. Sales to Distributing during the period ending on Date H will be based on historical cost. Sales to Distributing after Date H, and sales to others, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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

(n) The Distribution is not part of a plan (or series of related transactions) pursuant to which one or more persons will acquire, directly or indirectly, stock

possessing 50 percent or more of the combined voting power of all classes of stock of Distributing or Controlled entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing or Controlled stock, within the meaning of § 355(e).

(o) Until Date G, Parent was owned equally by Sub 2 and Corp J. On Date G, Sub 2 merged with a subsidiary of Parent and survived the merger, and Corp J merged downstream into Parent. The taxpayer represents that both mergers qualified as reorganizations under § 368.

### **Contribution and Distribution Rulings**

Based solely on the information submitted and the representations set forth above, we rule as follows:

(1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be a “party to a reorganization” under § 368(b).

(2) Gain, if any, will be recognized by Distributing on the Contribution in an amount not exceeding the fair market value of the promissory note received by Distributing (§ 361(b)(1)(B)). No loss will be recognized (§ 361(b)(2)).

(3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).

(4) The basis of the assets received by Controlled in the Contribution will equal the basis of the assets in the hands of Distributing, increased by any gain recognized by Distributing on the Contribution (§ 362(b)).

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

(6) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).

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

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

(9) Earnings and profits will be allocated between Distributing and Controlled in

accordance with §§ 312(h), 1.312-10(a), and 1.1502-33(f)(2).

### **Caveats**

We express no opinion on the federal income tax treatment of the proposed transaction under other provisions of the Code or regulations (including the consolidated return regulations) or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically covered by the above rulings. In particular, no opinion is given on:

- (a) the formation of Holding described above in step (i);
- (b) the transfer of assets by Sub 5 to Holding described above in step (ii);
- (c) the transfer of Controlled stock by Parent to Holding described above in step (v);
- (d) the transfer of Business A assets (received from Sub 5) by Holding to Controlled described above in step (vi);
- (e) the transfer of Sub 4 stock to Holding or the formation of Sub 6 described above in step (vii); or
- (f) the contribution of assets to Sub 4 or Sub 6 described above in step (vii).

Temporary or final regulations relating to one or more of the issues addressed in this ruling (including regulations under § 358(g)) have yet to be adopted. Therefore, this ruling letter may be modified or revoked if adopted temporary or final regulations are inconsistent with any provision conclusions reached herein. See section 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 47, which addresses, in greater detail, when a ruling will be revoked or modified. However, when the criteria in section 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is seldom revoked or modified retroactively, except in rare or unusual circumstances.

### **Separate Letter Ruling**

Rulings addressing certain depreciation aspects of the transaction will be the subject of a separate private letter ruling issued by the Passthroughs and Special Industries Division of the Office of Chief Counsel.

### **Procedural Statements**

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

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

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer and to a second authorized representative..

Sincerely,

Assistant Chief Counsel (Corporate)  
By: Wayne T. Murray  
Senior Technician Reviewer