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Department of the Treasury
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Person To Contact:
, ID No.

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Refer Reply To:
CC:CORP:1
PLR-137576-10

Date:
December 17, 2010

LEGEND:

Parent =

Sub =

LLC1 =

State X =

State Y =

Business A =

Business B =

LLC1 Interest =

PLR-137576-10

2

Date A =

Date B =

Date C =

Business A Assets =

Obligations =

Reimbursement Distributions =

Agreement A =

Agreement B =

Agreement C =

Section 1.752-7 Liabilities =

a =
b =
c =
d =
e =
f =
g =
h =

Dear _____ :

This letter responds to your September 13, 2010, request for rulings on certain federal income tax consequences of the Proposed Transaction. The information provided in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

SUMMARY OF FACTS

Parent, a publicly-traded State X corporation, is the common parent of an affiliated group of corporations filing a consolidated U.S. federal income tax return.

Parent owns all of the outstanding common and preferred stock of Sub, a State Y corporation. Sub's preferred stock is non-voting preferred stock that is redeemable for \$a (the "Redemption Amount") b years following its issuance. The preferred stock has an annual dividend cumulatively payable at a rate of c percent of the Redemption Amount. Upon liquidation, the Sub preferred stock is entitled to a liquidation preference

equal to the Redemption Amount plus any accrued and unpaid dividends. On the effective date of the Conversion (defined below), the terms of the Sub preferred stock will be amended to provide that such stock will be redeemable d years following its issuance. Parent has debt outstanding to Sub of approximately \$e (the “Intercompany Debt”), which may increase to \$f prior to the Proposed Transaction (defined below).

Sub conducts through its direct and indirect subsidiaries Business A operations and Business B operations. All of Sub’s Business A operations are held by LLC1.

LLC1, a State X limited liability company that is classified as a partnership for U.S. federal income tax purposes, was formed on Date A. On Date B, Agreement C was executed. Pursuant to Agreement C, Sub contributed the Business A Assets to LLC1 in exchange for the LLC1 Interest and LLC1’s assumption of liabilities related to Business A, including the Obligations. In the case of certain of the Business A Assets, the fair market value, or §704(b) of the Internal Revenue Code book basis, of the asset on Date B exceeded Sub’s adjusted basis for the asset on that date. In the case of each of the remaining Business A Assets, Sub’s adjusted basis for the asset on Date B exceeded the fair market value, or §704(b) book basis, of the asset on that date. With respect to the Obligations, the basis of Sub’s assets did not increase, and none was created, when Sub incurred the Obligations, and Sub had not, as of Date B, deducted any amount or realized any non-deductible, non-capitalizable expense with respect to the Obligations. Sub’s capital account in LLC1 was credited with the fair market value of the Business A Assets for purposes of §704(b) and debited by the present value of the Obligations. At all relevant times, Sub has owned shares in LLC1 representing a g percent economic interest and a h percent voting interest.

THE PROPOSED TRANSACTION

To achieve state income tax savings and to enhance management focus within Sub, Parent proposes the following transaction (the “Proposed Transaction”):

- (i) Sub will convert under State Y law to a single-member limited liability company (“Sub LLC”) that will be disregarded as an entity separate from its owner for U.S. federal tax purposes (such an entity, a “Disregarded Entity,” and such conversion, the “Conversion”).
- (ii) Sub LLC will assign and transfer the LLC1 Interest to Parent.
- (iii) Parent will assign and transfer the LLC1 Interest to a newly-formed State X limited liability company that will be classified as a Disregarded Entity (“LLC2”) in exchange for all of the membership interests in LLC2.
- (iv) Sub LLC will distribute the Intercompany Debt to Parent.

- (v) Sub LLC will convert to a corporation (“New Sub”) under State Y law (the “Reincorporation”).

REPRESENTATIONS

Conversion

Parent makes the following representations with respect to the Conversion:

- (a) The fair market value of the Parent stock that will be deemed to be received by Parent in the Conversion will be approximately equal to the fair market value of the Sub stock that will be deemed to be surrendered in the exchange.
- (b) Parent 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 Sub immediately prior to the transaction. For purposes of this representation, amounts used by Sub to pay its reorganization expenses, amounts paid by Sub to shareholders who receive cash or other property, and all redemptions and distributions (except for regular, normal dividends) made by Sub immediately preceding the transfer will be included as assets of Sub held immediately prior to the transaction.
- (c) During the five-period ending on the date of the Conversion: (a) no person related (as defined in §1.368-1(e)(4) of the Income Tax Regulations) to Parent will have acquired Sub stock with consideration other than Parent stock; (b) no person related to Parent will have acquired or redeemed Sub stock with consideration other than Parent stock or Sub stock; and (c) no distribution will have been made with respect to the stock of Sub, other than ordinary, normal, regular dividend distributions made pursuant to the historic dividend paying practice of Sub, either directly or through any transaction, agreement or arrangement with any other person.
- (d) Parent has no plan or intention to sell or otherwise dispose of any of the assets of Sub that will be deemed to be acquired in the transaction, except for dispositions made in the ordinary course of business or transfers described in §368(a)(2)(C) or §1.368-2(k).
- (e) Sub will be treated as distributing the Parent stock that it will be deemed to receive in the Conversion, and its other properties, in pursuance of the plan of reorganization.
- (f) The liabilities of Sub that will be deemed to be assumed by Parent (within the meaning of §357(d)) were incurred by Sub in the ordinary course of its business

and are associated with the assets that will be deemed to be transferred to Parent.

- (g) Following the transaction, Parent will continue, either directly or through one or more members of Parent's qualified group (within the meaning of §1.368-1(d)(4)(ii)), the historic business of Sub or will use a significant portion of Sub's historic business assets in a business.
- (h) Parent will pay or assume the expenses, if any, of each party incurred in connection with the Conversion in accordance with the guidelines of Revenue Ruling 73-54, 1973-1 C.B. 189.
- (i) There is no intercorporate indebtedness existing between Parent and Sub that was issued, acquired or will be settled at a discount.
- (j) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv).
- (k) The total fair market value of the assets of Sub that will be deemed to be transferred to Parent in the Conversion will exceed the sum of: (i) the amount of any liabilities that will be deemed to be assumed (within the meaning of §357(d)) by Parent in the exchange; (ii) the amount of any liabilities owed to Parent by Sub that are discharged or extinguished in connection with the exchange, and (iii) the amount of cash and the fair market value of any other property (other than stock and securities permitted to be received under §361(a) without recognition of gain) received by Sub in the exchange. The fair market value of the assets of Parent will exceed the amount of its liabilities immediately after the Conversion.
- (l) Sub is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of §368(a)(3)(A).
- (m) Items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations as a result of the Conversion (see §1.1502-13 and -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).
- (n) The Conversion and the Reincorporation will be effected pursuant to a single plan.

Reincorporation

Parent makes the following representations with respect to the Reincorporation:

- (o) (i) No stock or securities will be issued or deemed to be issued for services rendered to or for the benefit of New Sub in connection with the Reincorporation, and (ii) no stock or securities will be issued or deemed to be issued for indebtedness of New Sub that is not evidenced by a security or for interest on indebtedness of New Sub which accrued on or after the beginning of the holding period of Parent for the debt.
- (p) All rights, title and interests for each copyright, in each medium of exploitation, will be deemed to be transferred to New Sub.
- (q) Parent will not retain any significant power, right, or continuing interest, within the meaning of §1253(b), in the franchises, trademarks or trade names that are deemed to be transferred.
- (r) None of the stock that will be deemed to be transferred in the Reincorporation is “§306 stock” within the meaning of §306(c) of the Code.
- (s) The Reincorporation is not the result of the solicitation by a promoter, broker, or investment house.
- (t) Parent will not retain any rights in the property that will be deemed to be transferred to New Sub.
- (u) The value of the stock that will be deemed to be received in exchange for accounts receivable will be equal to the net value of the accounts transferred.
- (v) The adjusted basis and the fair market value of the assets that will be deemed to be transferred by Parent to New Sub in the Reincorporation will exceed the amount of any liabilities that will be deemed to be assumed (within the meaning of §357(d)) by New Sub in the exchange.
- (w) The total fair market value of the assets that will be deemed to be transferred to New Sub in the Reincorporation will exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of §357(d)) by New Sub in the exchange, (ii) the amount of any liabilities owed to New Sub by Parent that are discharged or extinguished in connection with the exchange, and (iii) the amount of cash and the fair market value of any other property (other than stock permitted to be received under §351(a) without recognition of gain) received by Parent in the exchange. The fair market value of the assets of New Sub will exceed the amount of its liabilities immediately after the Reincorporation.
- (x) The liabilities of Parent that will be deemed to be assumed by New Sub (within the meaning of §357(d)) in the Reincorporation were incurred in the ordinary

course of business and are associated with the assets that will be deemed to be transferred to New Sub in the exchange.

- (y) At the time of the Reincorporation, there will be no indebtedness between Parent and New Sub, and there will be no indebtedness created in favor of Parent as a result of the Reincorporation.
- (z) None of the stock that will be deemed to be received by Parent in the Reincorporation will be §306 stock within the meaning of §306(c).
- (aa) The Reincorporation will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.
- (bb) All exchanges will occur on approximately the same date.
- (cc) There is no plan or intention on the part of New Sub to redeem or otherwise reacquire any stock or indebtedness that will be deemed to be issued in the Reincorporation.
- (dd) Taking into account any issuance of additional shares of New Sub stock, any issuances of stock for services; the exercise of any New Sub stock rights, warrants, or subscriptions; a public offering of New Sub stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of New Sub that will be deemed to be received in the Reincorporation, Parent will be in control of New Sub within the meaning of §368(c) of the Code.
- (ee) Parent will be deemed to receive stock of New Sub approximately equal to the fair market value of the property that will be deemed to be transferred to New Sub.
- (ff) New Sub will remain in existence and will retain and use the property that will be deemed to be transferred to it in a trade or business.
- (gg) There is no plan or intention by New Sub to dispose of the property that will be deemed to be transferred other than in the normal course of business operations.
- (hh) Parent will pay all of the expenses incurred in connection with the Reincorporation.
- (ii) New Sub will not be an investment company within the meaning of §351(e)(1) and §1.351-1(c)(1)(ii).

- (jj) Parent 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 Parent.
- (kk) New Sub will not be a “personal service corporation” within the meaning of §269A.
- (ll) At the time of the Reincorporation, the aggregate fair market value of the assets that will be deemed to be transferred by Parent to New Sub will equal or exceed Parent’s aggregate adjusted basis in those assets.
- (mm) The Reincorporation is not being undertaken with a view to prevent the consolidated return provisions from properly addressing loss duplication within the meaning of §1.1502-80(h).
- (nn) The New Sub preferred stock that will be deemed to be issued in the Reincorporation will not be nonqualified preferred stock within the meaning of §351(g).

Additional Representations

Parent makes the following additional representations.

- (oo) LLC1 has constituted a partnership for U.S. federal income tax purposes since its formation and at all relevant times.
- (pp) The Parties have complied and acted consistently with the terms of all relevant transaction documents, including Agreement A, Agreement B, and Agreement C.
- (qq) No person other than Sub contributed the Business A Assets to LLC1.
- (rr) Only Sub received the LLC1 Interest in exchange for the contribution of the Business A Assets.
- (ss) Sub has not transferred the LLC1 Interest or any portion thereof.
- (tt) Since its formation and at all relevant times, LLC1 has used the traditional method with curative allocations, described in §1.704-3(c), to account for §704(c) gain or loss attributable to the Business A Assets and the traditional method to account for §704(c) deductions attributable to Section 1.752-7 Liabilities.
- (uu) Allocations of profit and loss by LLC1, or items thereof, for purposes of §704(b) have had substantial economic effect.

- (vv) Except for the Reimbursement Distributions, all distributions from LLC1 to Sub have been distributions of operating cash flow.
- (ww) The Reimbursement Distributions constituted reimbursements of preformation expenditures as described in §1.707-4(d).
- (xx) All liabilities of Sub assumed by LLC1 on Date B and to which the Business A Assets were subject, other than the Obligations, were qualified liabilities within the meaning of §1.707-5(a)(6).
- (yy) There has not been a constructive termination of LLC1 under §708(b)(1)(B) and corresponding Treasury Regulations.
- (zz) As of Date C, LLC1's aggregate adjusted basis in partnership property does not exceed the aggregate fair market value of such property by more than \$250,000.
- (aaa) If the Proposed Transaction is executed, Parent will account for and report all items of income and gain attributable to the LLC1 Interest under §704(c) as required by §1.704-3(a)(7).

RULINGS

Conversion

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

- (1) For U.S. federal income tax purposes, the Conversion will be treated as a transfer by Sub of substantially all of its assets to Parent solely in exchange for Parent voting stock and Parent's assumption of Sub's liabilities followed by the distribution by Sub of the Parent voting stock to Parent in complete liquidation.
- (2) The deemed transfer by Sub of substantially all of its assets to Parent solely in exchange for Parent voting stock and Parent's assumption of Sub's liabilities followed by the distribution by Sub of the Parent voting stock to Parent in complete liquidation will qualify as a reorganization under §368(a)(1)(C). The Conversion will not be disqualified or recharacterized by reason of the Reincorporation. Section 368(a)(2)(C); §1.368-2(k). Sub and Parent will each be a "party to a reorganization" within the meaning of §368(b).
- (3) No gain or loss will be recognized by Sub on the deemed transfer of substantially all of its assets to Parent solely in exchange for shares of Parent voting stock and Parent's assumption of Sub's liabilities. Sections 361(a), 357(a).

- (4) No gain or loss will be recognized by Sub on the deemed distribution of Parent voting stock to Parent. Section 361(c).
- (5) No gain or loss will be recognized by Parent upon the deemed receipt of the assets of Sub solely in exchange for Parent voting stock. Section 1032(a).
- (6) The basis of the assets of Sub in the hands of Parent will be the same as the basis of those assets in the hands of Sub immediately prior to the Conversion. Section 362(b).
- (7) The holding period of the assets of Sub in the hands of Parent will include the period during which those assets were held by Sub. Section 1223(2).
- (8) No gain or loss will be recognized by Parent upon the deemed receipt of Parent voting stock solely in exchange for Sub stock. Section 354(a)(1).
- (9) Under §381(a) and §1.381-1, the taxable year of Sub will end on the effective date of the closing of the Conversion, and Parent will succeed to and take into account the items of Sub described in §381(c), subject to the provisions and limitations specified in §§ 381, 382, 383, and 384, and the regulations thereunder.
- (10) Parent will not realize income under §61(a)(12) or §1.301-1(m) with respect to the extinguishment of the Intercompany Debt in the Conversion. See Rev. Rul. 74-54, 1974-1 C.B. 76.

Reincorporation

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

- (11) For U.S. Federal income tax purposes, the Reincorporation will be treated as the transfer by Parent of the assets remaining in Sub LLC after step (iv) of the Proposed Transaction to New Sub in deemed exchange for stock of New Sub.
- (12) No gain or loss will be recognized by Parent as a result of the Reincorporation. Sections 351(a), 357(a).
- (13) The basis of each asset received by New Sub will equal the basis of such asset in the hands of Parent immediately before the Reincorporation. Section 362(a).
- (14) The holding period of each asset received by New Sub will include the holding period of such asset in the hands of Parent. Section 1223(2).
- (15) No gain or loss will be recognized by New Sub as a result of the issuance of New Sub stock in the Reincorporation. Section 1032(a).

- (16) The basis of the New Sub stock received by Parent will equal the basis of the assets transferred by Parent in the Reincorporation, decreased by the amount of liabilities, if any, assumed by New Sub in the Reincorporation. Section 358(a), (d).
- (17) The holding period of New Sub stock deemed received by Parent will include the holding period of the assets transferred to New Sub, provided that the assets are held by Parent as capital assets on the date of the exchange. Section 1223(1).

Additional Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows with respect to the Proposed Transaction:

- (18) As a result of the Proposed Transaction, unless limited by §704(c)(1)(C), Parent will succeed to the §704(c) items of Sub attributable to the LLC1 Interest under §1.704-3(a)(7).
- (19) The Proposed Transaction will not cause §704(c)(1)(C) to limit the allocation to Parent under §704(c) of items of loss or deduction attributable to the LLC1 Interest.

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

PROCEDURAL STATEMENTS

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

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

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Mark Weiss
Reviewing Attorney, Branch 1
(Corporate)