**Internal Revenue Service**

Department of the Treasury

Washington, DC 20224

Number: **200103052**
Release Date: 1/19/2001
Index Number: 0305.00-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:2-PLR-112913-00
Date:
October 24, 2000

LEGEND:

Parent =

FSUB 1 =

FSUB 2 =

Target Company =

Employee =

State A =

Country B =

Country C =

d =

Business =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Dear:

This responds to your letter, dated June 28, 2000, requesting rulings on behalf of the above referenced taxpayer as to the federal income tax treatment of a proposed transaction. Specifically, rulings were requested under § 305 of the Internal Revenue Code. Additional information was provided in letters dated October 2, 2000, October 5, 2000, and October 10, 2000**.** The information submitted for consideration is summarized below.

The information submitted indicates that Parent is a publicly-held domestic corporation organized under the laws of State A. Parent is the common parent of a consolidated group (the "P group") that files a consolidated return based on a 52/53 week fiscal year ending on the Friday nearest January 31. Parent is engaged directly, and indirectly through its subsidiaries, in Business.

On Date 1, Parent formed FSUB 1, a wholly owned subsidiary, under the laws of Country B in order to acquire the assets of unrelated Target Company, which engaged in a similar business. On Date 2, FSUB 1 purchased Target Company's assets (the "Asset Purchase"). In connection with the Asset Purchase, Parent entered into two agreements with Employee, an officer of Company, to ensure that Employee would continue to run the acquired business. The first agreement (Agreement 1), granted Employee options to acquire from Parent a 20 percent equity interest in FSUB 1 for a sum certain. Such options would vest over a 3-year period ending on Date 3. The second agreement (Agreement 2) provided that upon the vesting of the options under Agreement 1, Parent could offer to repurchase all of the stock in FSUB 1 at fair market value. The agreement further provides that, if Parent fails to make such offer within 30 days of Employee's exercise of his option, Parent would grant Employee an option to

acquire an additional 35 percent of FSUB 1 for a sum certain. Taxpayer represents that each agreement was valid and enforceable under the laws of Country B.

On Date 4, Employee exercised the option rights granted under Agreement 1 to receive a 20 percent equity interest in FSUB 1. On Date 5, under Agreement 2, Parent paid Employee $d (fair market value) in exchange for Employee's 20 percent equity interest in FSUB 1,

On Date 6, Parent formed FSUB 2 under the laws of Country C. Also on Date 6, Parent contributed all of the stock of FSUB 1 to FSUB 2. On Date 7, FSUB 1 filed an election pursuant to § 301.7701-3 of the Procedure and Administration Regulations to be disregarded as an entity separate from its owner (the "Election"). The Election was effective as of Date 6. The Taxpayer has represented that the contribution by Parent of all the stock of FSUB 1 to FSUB 2, followed by the Election, constituted a reorganization under § 368(a)(1)(D) of the Internal Revenue Code.

For valid business reasons, the following transaction is proposed:

(i) FSUB 1 will make a $d payment to Parent.

(ii) Parent will use the payment described in step (i) to subscribe for additional deemed shares in FSUB 2. On Date 8, Parent and FSUB 2 entered into an Agreement (Agreement 3) providing that, contingent on receipt of the $d payment, Parent is irrevocably bound to use the $d payment from FSUB 1 (which is now a division of FSUB 2) to subscribe for additional deemed shares in FSUB 2. No additional shares will be issued.

The following representations are made in connection with the proposed transaction:

(a) The sole purpose of the proposed transaction is to enable FSUB 1 to claim a deduction for Country B tax purposes.

(b) Parent is irrevocably bound to utilize the $d payment to be received from FSUB 1, a division of FSUB 2, to cover a new share issuance in FSUB 2, and there is no option to apply the proceeds in any other manner or to any other purpose.

(c) At the time that Parent entered into Agreement 1 and Agreement 2, there was no agreement or understanding that FSUB 1 would reimburse Parent for any amounts paid to Employee under those agreements.

(d) On Date 5, when Parent made the payment to Employee to repurchase his stock in FSUB 1, there was no agreement or understanding that FSUB 1 would reimburse Parent for the payment to Employee.

(e) FSUB 2 will have earnings and profits sufficient to support dividend treatment of the $d payment from FSUB 1 to Parent.

(f) The agreement binding Parent to cover the new shares in FSUB 2 with the $d payment is valid and enforceable under the law of Country B.

(g) Parent did not take a deduction for the payment of the $d to Employee.

(h) There is no current intention to dispose of a 10% or greater interest in FSUB 1 within the next 12 months.

(i) Taxpayer will comply with the foreign currency rules under §§ 987 and 988.

(j) Other than the deduction in the Country B, Parent, FSUB 1, and FSUB 2 will not be claiming any benefits under either the US, Country B, or Country C Income tax treaty.

(k) No foreign tax credits under §§ 901-903 will be claimed by Parent on the distribution.

The representations submitted form a material basis for the issuance of our rulings. Provided FSUB 2 is an association taxable as a corporation for federal income tax purposes, and based solely on the information submitted and on the representations set forth above, we rule as follows:

(1) The proposed transaction, as described in steps (i) and (ii) above, will be treated as a distribution by FSUB 2 of its common stock with respect to its common stock. The stock distribution will not constitute gross income of FSUB 2's shareholder, Parent (§ 305(a) and Rev. Rul. 80-154, 1980-1 C.B. 68).

(2) The distribution by FSUB 2 to Parent, as described above, will not be considered a distribution of earnings and profits (§ 312(d)(1)(B)).

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter have not yet been adopted. Therefore, this ruling letter may be revoked or modified upon the issuance of temporary or final regulations (or a notice with respect to their future issuance). See section 12.04 of Rev. Proc. 2000-1, 2000-1 I.R.B. 4, which discusses in greater detail the revocation or modification of ruling letters. However, when the criteria in section 12.05 of Rev. Proc 2000-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for a ruling. Verification of the information, representations, and other data may be required as part of the audit process.

No opinion is expressed about the tax treatment of the proposed transactions 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 proposed transactions that are not directly covered by the above rulings. In particular, no opinion is expressed under § 301.7701-3.

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.

A copy of this letter should be attached to the federal income tax returns of the corporations involved for the taxable year in which the proposed transaction is completed.

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

Sincerely,

Associate Chief Counsel (Corporate)

By: _____

Lewis K Brickates
Assistant to the Chief, Branch 2