

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:2 PLR 108474-00

Date:

November 29, 2000

Distributing 1 =

Distributing 2 =

Distributing 3 =

Corp 4 =

Controlled =

State E =

Shareholder I =

Shareholder II =

Shareholder III =

Business A =

Business B =

City C =
City D =
X =
Y =

Z =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
O% =
P% =
Q% =

Dear:

This letter responds to your request for rulings about the federal income tax consequences of a proposed transaction. The information submitted and considered in your request is summarized below.

Shareholder I, Shareholder II, and Shareholder III own O%, P%, and Q% respectively of Distributing 3. Distributing 3 is the common parent of a consolidated group consisting of Distributing 1, Distributing 2, Distributing 3, Corp 4 and Controlled. Distributing 1, Distributing 2, Distributing 3, Corp 4 and Controlled use the accrual method of accounting and file their consolidated federal income tax returns on a calendar year basis.

Distributing 3 is a holding company that owns 100% of Distributing 2. Distributing 2, is an intermediate holding company that owns 100% of the stock of Distributing 1 and Corp 4. Distributing 1 and Corp 4 are engaged in Business A in City C and City D, respectively. Both Distributing 1 and Corp 4 are subject to the regulatory authority of X, a State E agency, and Y, a federal agency which regulate Business A. Distributing 3 and Distributing 2, as holding companies, are subject to the regulatory authority of Z, a federal agency.

Distributing 1 owns 100% of Controlled. Controlled was formed by Distributing 1 on Date 1 to conduct Business B in which it has been engaged for more than five years. Business B is regulated by Y and X only because Controlled is owned by Distributing 1.

On Date 2, Distributing 3 acquired the stock of Corp 4 in a transaction in which gain or loss was recognized by the selling shareholders. On Date 3, Distributing 3 contributed the stock of Distributing 1 and Corp 4 to Distributing 2 in exchange for 100% of Distributing 2's stock, in a transaction represented to qualify under Section 351. From Date 3 until present, Distributing 2 has owned 100% of the stock of Distributing 1 and Corp 4.

During the last two years, X and Y have become increasingly concerned that Business B, as conducted by Controlled, exposes Distributing 1 to economic risks. On Date 4, to address the regulatory concerns of both X and Y, Distributing 1 signed an agreement under which Distributing 1 agreed to sell or distribute its ownership in Controlled. Distributing 1 has been unable to sell Controlled and, under the agreement, will be required to distribute its ownership in Controlled to Distributing 2.

Distributing 3 and Distributing 2 have been informed by Z that the holding companies will be subject to additional regulatory burdens, scrutiny and review if either continues to own Controlled, including requirements that the holding company owning Controlled maintain additional loss reserves and capital and limit its debt leverage.

To allow Distributing 1 to meet its agreement with X and Y and to allow Distributing 2 and Distributing 3 to avoid the additional regulatory burdens and restrictions that will be imposed by Z, the following transaction has been proposed.

Upon approval by X and Y with respect to the Merger (hereinafter defined) and Distribution 1 and by Z with respect to Distribution 2 and Distribution 3, and the issuance by the Internal Revenue Service of the rulings requested herein, the transactions will be completed in the sequences set forth below.

- (A) First, Corp 4 will merge with and into Distributing 1 with Distributing 1 surviving (the "Merger"). In the Merger, Distributing 2 as the sole shareholder of Corp 4 will receive solely stock of Distributing 1. The separate corporate existence of Corp 4 will cease as a result of the Merger and Business A as conducted by Distributing 1 before the Merger and Business A as conducted by Corp 4 before the Merger will be continued by Distributing 1 after the Merger.
- (B) Second, Distributing 1 will distribute all of the common stock of Controlled ("Controlled Common Stock") to Distributing 2 (the "First Distribution");
- (C) Third, Distributing 2 will distribute all of the Controlled Common Stock to Distributing 3 (the "Second Distribution"); and

- (D) Fourth, Distributing 3 will distribute all of the Controlled Common Stock to its shareholders (the “Third Distribution”) pro rata with respect to their ownership of Distributing 3 common stock (“Distributing 3 Common Stock”)

Collectively, the First, Second and Third Distributions are referred to as the “Distributions.”

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

- (1) Following the Merger, Corp 4 will cease its separate corporate existence and the assets and liabilities of Corp 4 will become assets and liabilities of Distributing 1.
- (2) The Merger of Corp 4 with and into Distributing 1 with Distributing 1 surviving will qualify as a reorganization described in Section 368(a)(1)(D).

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

- (1) No part of the consideration to be distributed by Distributing 3 in the Third Distribution is being received by a shareholder of Distributing 3 as a creditor, employee or in any capacity other than that of a shareholder of Distributing 3.
- (2) No part of the consideration to be distributed by Distributing 2 in the Second Distribution is being received by a shareholder of Distributing 2 as a creditor, employee or in any capacity other than that of a shareholder of Distributing 2.
- (3) No part of the consideration to be distributed by Distributing 1 in the First Distribution is being received by a shareholder of Distributing 1 as a creditor, employee or in any capacity other than that of a shareholder of Distributing 1.
- (4) The five years of financial information provided on behalf of Distributing 1 is representative of Distributing 1's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (5) The financial information provided on behalf of Distributing 2 is representative of Distributing 2's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (6) The five years of financial information provided on behalf of Distributing 3 is representative of Distributing 3's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

- (7) The five years of financial information provided on behalf of Controlled is representative of Controlled's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (8) Following the Distributions, Distributing 1, Distributing 2, and Distributing 3 on the one hand and Controlled on the other hand will each continue the active conduct of their respective trades or businesses, independently and with their separate employees.
- (9) Distributing 1, Distributing 2, Distributing 3, Controlled, and their respective shareholders will each pay their own expenses, if any, incurred in connection with the Distributions.
- (10) The distribution of Controlled Common Stock by Distributing 3 will be pro rata with respect to the holders of Distributing 3 Common Stock.
- (11) The distribution of Controlled Common Stock by Distributing 1 to Distributing 2 in the First Distribution is carried out for the corporate business purpose of compliance with the State E agency X's determination letter requiring the divestiture of Controlled. The distribution of Controlled Common Stock in the First Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (12) The distribution of Controlled Common Stock by Distributing 2 to Distributing 3 in the Second Distribution is carried out for the corporate business purpose of avoiding the additional regulatory requirements that would be imposed upon Distributing 2 or Distributing 3 by Z if Distributing 2 were to hold Controlled Common Stock. The distribution of Controlled Common Stock in the Second Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (13) The distribution of Controlled Common Stock by Distributing 3 to the shareholders of Distributing 3 in the Third Distribution is carried out for the corporate business purpose of avoiding the additional regulatory requirements that would be imposed upon Distributing 3 by Z if Distributing 3 were to hold Controlled Common Stock. The distribution of Controlled Common Stock in the Third Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (14) Immediately after the Distributions, at least 90 percent of the fair market value of the gross assets of Distributing 2 will consist of stock of controlled corporations that are engaged in the active conduct of a trade or business as defined in Section

355(b)(2).

- (15) Immediately after the Distributions, at least 90 percent of the fair market value of the gross assets of Distributing 3 will consist of stock of corporations at least 90 percent of the fair market value of whose gross assets will consist of stock of controlled corporations that are engaged in the active conduct of a trade or business as defined in Section 355(b)(2).
- (16) Distributing 1, Distributing 2, and Distributing 3 are not S corporations (within the meaning of Section 1361(a)), and there is no plan or intention by Distributing 1, Distributing 2, Distributing 3, or Controlled to make an S corporation election pursuant to Section 1362(a).
- (17) There is no plan or intention by the shareholders of Distributing 3 to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing 3 or Controlled after the Distributions.
- (18) There is no plan or intention by either Distributing 3 or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distributions.
- (19) There is no plan or intention to liquidate Distributing 1, Distributing 2, Distributing 3 or Controlled, to merge Distributing 1, Distributing 2, Distributing 3, or Controlled with any other corporation, or to sell or otherwise dispose of the assets of any of these corporations after the Distributions, except in the ordinary course of business.
- (20) Neither Distributing 3 nor any of its subsidiaries have accumulated their receivables or made extraordinary payment of their payables in anticipation of the Distributions.
- (21) After the Distributions, Distributing 1 will continue to hold certain deposits of Controlled in the ordinary course of Distributing 1's business. Except for Distributing 1's indebtedness to Controlled for this deposit liability, no intercorporate debt will exist between Distributing 3 or any of its subsidiaries on the one hand, and Controlled on the other hand, at the time of, or subsequent to, the Distributions.
- (22) Immediately before the Distributions, items of income, gain, loss, deduction and credit will be taken into account as required by the applicable intercompany transaction regulations under Treasury Regulations 1.1502-13 and 1.1502-14 as in effect at the time of the Distributions.

- (23) Immediately before and immediately after the Distributions, none of Distributing 1, Distributing 2 and Distributing 3 will have an excess loss account with respect to the stock of any subsidiary.
- (24) Payments made in connection with all continuing transactions, if any between Distributing 3 or its subsidiaries and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (25) No party to the Distributions is an investment company as defined in Section 368(a)(2)(F)(iii) and (iv).
- (26) None of Distributing 1, Distributing 2, Distributing 3, Corp 4 and Controlled is or will be a foreign corporation.
- (27) No money or property (other than Controlled Common Stock) will be received by Distributing 1, Distributing 2, Distributing 3, or the shareholders of Distributing 3 in connection with the Distributions.
- (28) For purposes of Section 355(d), immediately after the First Distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Distributing 1 stock, that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five year period (determined after applying Section 355(d)(6)) ending on the date of Distribution 1.
- (29) For purposes of Section 355(d), immediately after the First Distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Controlled stock, that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five year period (determined after applying Section 355(d)(6)) ending on the date of Distribution 1.
- (30) For purposes of Section 355(d), immediately after the Second Distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Distributing 2 stock, that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five year period (determined after applying Section 355(d)(6)) ending on the date of Distribution 2.

- (31) For purposes of Section 355(d), immediately after the Second Distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Controlled stock, that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five year period (determined after applying Section 355(d)(6)) ending on the date of Distribution 2.
- (32) For purposes of Section 355(d), immediately after the Third Distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares all classes of Distributing 3 stock, that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five year period (determined after applying Section 355(d)(6)) ending on the date of Distribution 3.
- (33) For purposes of Section 355(d), immediately after the Third Distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares all classes of Controlled stock, that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five year period (determined after applying Section 355(d)(6)) ending on the date of Distribution 3.

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

- (1) Distributing 1 will recognize no gain or loss upon the distribution of the Controlled Common Stock to Distributing 2 in the First Distribution. Section 355(c).
- (2) Distributing 2 will recognize no gain or loss (and no amount of gain or loss will be included in the income of Distributing 2) upon the receipt of the Controlled Common Stock from Distributing 1 in the First Distribution. Section 355(a)(1); Rev. Rul. 62-138, 1962-2 C.B. 95.
- (3) The aggregate basis of the Distributing 1 common stock and the Controlled Common Stock in the hands of Distributing 2 after the First Distribution will equal the basis of the Distributing 1 common stock held by Distributing 2 immediately before the First Distribution, allocated in proportion to their relative fair market values in accordance with Treasury Regulation Section 1.358-2(a)(2). Sections 358(b) and 358(c).

- (4) The holding period of the Controlled Common Stock received by Distributing 2 will include Distributing 2's holding period of the Distributing 1 common stock on which the distribution of the Controlled Common Stock by Distributing 1 will be made, provided that such Distributing 1 common stock is held as a capital asset on the date of the First Distribution. Section 1223(1); Treasury Regulation Section 1.1223-1(a).
- (5) The current and accumulated earnings and profits of Distributing 1 shall be adjusted as required under Section 312(h) and Treasury Regulation Sections 1.312-10(b) and 1.1502-33.
- (6) Distributing 2 will recognize no gain or loss on the distribution of Controlled Common Stock to Distributing 3 in the Second Distribution. Section 355(c).
- (7) Distributing 3 will recognize no gain or loss (and no amount of gain or loss will be included in the income of Distributing 3) upon the receipt of the Controlled Common Stock from Distributing 2 in the Second Distribution. Section 355(a)(1); Rev. Rul. 62-138, 1962-2 C.B. 95.
- (8) The aggregate basis of the Distributing 2 common stock and the Controlled Common Stock in the hands of Distributing 3 after the Second Distribution will equal the basis of the Distributing 2 common stock held by Distributing 3 immediately before the Second Distribution, allocated in proportion to their relative fair market values in accordance with Treasury Regulation Section 1.358-2(a)(2). Sections 358(b) and 358(c).
- (9) The holding period of the Controlled Common Stock received by Distributing 3 will include Distributing 3's holding period of the Distributing 2 common stock on which the distribution of the Controlled Common Stock by Distributing 2 will be made, provided that such Distributing 2 common stock is held as a capital asset on the date of the Second Distribution. Section 1223(1); Treasury Regulation Section 1.1223-1(a).
- (10) The current and accumulated earnings and profits of Distributing 2 shall be adjusted as required under Section 312(h) and Treasury Regulation Sections 1.312-10(b) and 1.1502-33.
- (11) Distributing 3 will recognize no gain or loss on the distribution of Controlled Common Stock to its shareholders in the Third Distribution. Section 355(c).
- (12) The shareholders of Distributing 3 will recognize no gain or loss (and no amount of gain or loss will be included in the income of any shareholder of Distributing 3) on the receipt of Controlled Common Stock from Distributing 3 in the Third

Distribution. Section 355(a)(1).

- (13) The aggregate basis of the Distributing 3 Common Stock and the Controlled Common Stock in the hands of each shareholder of Distributing 3 after the Third Distribution will equal the basis of the Distributing 3 Common Stock held by each shareholder immediately before the Third Distribution, allocated in proportion to their relative fair market values in accordance with Treasury Regulation Section 1.358-2(a)(2). Sections 358(b) and 358(c).
- (14) The holding period of Controlled Common Stock received by a shareholder of Distributing 3 in the Third Distribution will include the holding period of the Distributing 3 Common Stock on which the distribution of the Controlled Common Stock by Distributing 3 will be made, provided that such Distributing 3 Common Stock is held as a capital asset on the date of the Third Distribution. Section 1223(1); Treasury Regulation Section 1.1223-1(a).
- (15) The current and accumulated earnings and profits of Distributing 3 shall be adjusted as required under Section 312(h) and Treasury Regulation Sections 1.312-10(b) and 1.1502-33.

We express no opinion about the tax treatment of the proposed transaction under any other provisions of the Code or 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, we express no opinion regarding whether section 351 applied to the formation of Distributing 2 or whether the merger of Corp 4 into Distributing 1 is described in section 368.

Temporary or final regulations pertaining to one or more issues addressed in this ruling letter (including regulations under Sections 355(d) and 358(g)) have not yet been adopted. Therefore, this ruling letter may be revoked or modified if adopted temporary or final regulations are inconsistent with any conclusions reached herein. See section 12.04 of Rev. Proc. 2000-1, 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. 2000-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

The rulings in this letter are based on the facts and representations submitted under perjury in support of the request. Verification of that information may be required as part of the audit process.

This ruling letter has no effect on any earlier document and is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

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

Sincerely,

Associate Chief Counsel (Corporate)

By:

Lewis K Brickates

Assistant to Branch Chief (Corporate)