

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200449009**

Release Date: 12/3/04

Index Number: **355.00-00**

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

**CC:CORP:1 – PLR-115913-04**

Date:

August 5, 2004

In Re:

Distributing =

Controlled 1 =

Controlled 2 =

New Parent =

FSub2 =

FSub3 =

C1Sub1 =

C1Sub3 =

PLR-115913-04

C1FSub1 =

Country A =

Authority =

Dear

This letter responds to your letter dated March 15, 2004, in which you requested supplemental rulings to our initial ruling letter dated February 13, 2004, PLR-147741-03 (the "Prior Letter Ruling"). The Prior Letter Ruling addresses the federal income tax consequences of a proposed transaction under section 355 of the Internal Revenue Code (the "Code") consisting of a Domestication and Distributions. The Domestication and Distributions have not yet been consummated. Capitalized terms not defined in this letter retain the meanings assigned in the Prior Letter Ruling and the facts and representations set forth in the Prior Letter Ruling are hereby incorporated, except as modified below, for purposes of the supplemental rulings. Additional information was submitted in letters dated April 23 and July 16, 2004.

You have proposed modifications to some of the steps in the Proposed Transaction in the Prior Letter Ruling. These modifications are necessary to accelerate the timing of some of the steps in the Proposed Transaction to take advantage of the increase in share price that is expected to result from the Domestication and Distributions. Also, it is necessary to receive a ruling from the Authority on some of the steps in the Proposed Transaction and the ruling may not be received in time to permit the Domestication and Distributions to occur as soon as is desirable. Consequently, in order to accomplish the Domestication and Distributions in the shortest possible time frame, the Proposed Transaction is being revised so that the Distributions will be effected immediately after the Domestication.

Accordingly, the steps in the Proposed Transaction described in the Prior Letter Ruling have been modified (the "Proposed Modified Transaction") to occur as follows:

(i) Distributing will distribute all the shares in Controlled 1 and FSub2 to FSub3 (collectively the "Modified Distributions").

(ii) New Parent will form New Controlled 1, a corporation. New Controlled 1 in turn will form New C1Sub1 and New C1Sub1 will form New C1Sub3. New C1Sub3

PLR-115913-04

will file an election under section 301.7701-3 to be treated as a corporation for tax purposes.

(iii) C1Sub3 will sell all of its interests in C1FSub1 to New C1Sub3 for a promissory note ("Note 1").

(iv) Controlled 1 will redeem the approximately E percent of its shares held directly by FSub3 for a newly issued note of approximately equal value ("Note 2").

(v) FSub3 will distribute Note 2 to New Parent.

(vi) New Parent will contribute Note 2 to New Controlled 1 as capital.

(vii) (a) New Parent will merge New Controlled 1 into Controlled 1; (b) Controlled 1 will merge New C1Sub1 into C1Sub1; (c) C1Sub1 will contribute all of the interests in New C1Sub3 to C1Sub3, and New C1Sub3 will file an election under section 301.7701-3 to be treated as a disregarded entity. In connection with steps (vii)(a) through (c), as described in the Prior Letter Ruling, the receivable and payable positions with respect to Notes 1 and 2 will be owned by the same corporate entity, and will therefore be cancelled.

(viii) FSub3 will distribute the FSub2 stock to New Parent as a reduction of capital.

The taxpayer made the following representations in connection with the Proposed Modified Transaction (as recast below in Ruling 1, below):

- a. All transfers of property made in connection with the Proposed Modified Transaction were made in exchange for stock or property with a fair market value approximately equal to the property exchanged therefor.
- b. Any indebtedness owed by either Controlled 1 or Controlled 2 to Distributing after the Proposed Modified Transaction will not constitute stock or securities.
- c. No part of the consideration to be distributed by Distributing will be received by New Parent (as the sole shareholder of FSub3) as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- d. The five years of financial information submitted on behalf of Business A, Business B, Business C, and Business D, Business E, and Business F is representative of each business' present operations and there have been

PLR-115913-04

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

- e. Immediately after the Modified Distributions, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock and securities of FSub1, which is a controlled corporation directly engaged in the active conduct of Business A.
- f. Immediately after the Modified Distributions, FSub1 will be directly engaged in Business A through its ownership of a B percent partnership interest in FP2. The value of the B percent partnership interest will satisfy the active trade or business requirements of section 355(b) and, have a fair market value that is not less than five percent of the total fair market value of the gross assets of FSub1.
- g. Immediately after Modified Distribution 1, over 90 percent of the gross assets of Controlled 1 will consist of the stock of C1Sub5 and C1Sub1. C1Sub5 will be directly engaged in Business D, Business E, and Business F, and not less than five percent of the total fair market value of the gross assets of C1Sub5 will be used in the conduct of Business D, Business E, and Business F. C1Sub1 will be indirectly engaged in Business C through its ownership of all of the interests in C1Sub3, the value of which represents over 90 percent of the total fair market value of the assets of C1Sub1. C1Sub3 will be directly engaged in Business C through its B percent ownership interest in FP4, a partnership for tax purposes, and not less than five percent of the total fair market value of the gross assets of C1Sub3 will consist of its partnership interest in FP4.
- h. Immediately after Modified Distribution 2, Controlled 2 will be directly engaged in Business B through its B percent partnership interest in FP5. Not less than five percent of the total fair market value of the gross assets of Controlled 2 will consist of its partnership interest in FP5.
- i. Following the Modified Distributions, Distributing, Controlled 1, and Controlled 2 will each continue the active conduct of its business, independently and with its separate employees.
- j. The Modified Distributions (coupled with the Domestication) will significantly enhance the stock value of New Parent to make continued acquisitions, raise funds, and retire debt. The Modified Distributions are motivated, in whole or substantial part, by this corporate business purposes.

PLR-115913-04

- k. There is no plan or intention by New Parent (as the sole shareholder of FSub3) to sell, exchange, transfer by gift, or otherwise dispose of their stock in, or securities of, either Distributing, Controlled 1 or Controlled 2 after the Modified Distributions.
- l. There is no plan or intention by Distributing, Controlled 1 or Controlled 2, directly or through a subsidiary corporation, to purchase any of its outstanding stock after the Modified Distributions.
- m. There is no plan or intention to liquidate Distributing, Controlled 1, or Controlled 2, to merge Distributing, Controlled 1 or Controlled 2 with any other corporation, or to sell or otherwise dispose of the assets of Distributing, Controlled 1 or Controlled 2 after the Modified Distributions, except in the ordinary course of business.
- n. The total adjusted basis and the fair market value of the assets transferred to Controlled 2 by Distributing (if any), each equals or exceeds the sum of the liabilities assumed by Controlled 2 respectively, plus any liabilities to which the transferred assets are subject. The liabilities assumed in the Proposed Modified Transaction and the liabilities to which the transferred assets are subject (if any) were incurred in the ordinary course of business and are associated with the assets being transferred.
- o. No assets will be transferred by Distributing to Controlled 1 or Controlled 2 in connection with the Proposed Modified Transaction.
- p. Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.
- q. Distributing, Controlled 1, and Controlled 2 each uses the accrual method of accounting for tax purposes.
- r. Payments made in connection with all continuing transactions, if any, between Distributing, Controlled 1 and/or Controlled 2, will be on terms and conditions believed by the relevant parties to be comparable to terms and conditions obtainable in similar transactions with unaffiliated third-parties bargaining at arm's-length.
- s. No parties to the Proposed Modified Transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- t. Distributing is not an S corporation (within the meaning of section 1361(a)), and there is no plan or intention by Distributing, Controlled 1, or

PLR-115913-04

Controlled 2 to make an S corporation election pursuant to section 1362(a).

- u. At all times during the five-year period preceding the Modified Distributions, greater than five-percent shareholders have not purchased at least 50 percent of the aggregate combined voting power and aggregate value of outstanding Distributing stock, within the meaning of Treas. Reg. section 1.355-6(f)(4). Management of Distributing has no actual or deemed knowledge that any less-than-five-percent shareholder acquired stock or securities in Distributing by purchase during the five-year period preceding the Modified Distribution, within the meaning of section 355(d)(5) and (8).
- v. The transfer by Distributing's shareholders of all of the stock of Distributing to New Parent, solely in exchange for stock of New Parent, will qualify as a tax-free transaction under Section 351 for federal income tax purposes.
- w. For purposes of section 355(d), immediately after the Modified Distributions, 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 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 the Modified Distributions.
- x. For purposes of section 355(d), immediately after the Modified Distributions, 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 1 or Controlled 2 stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) or (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Modified Distributions, or (ii) attributable to distributions on Distributing 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 the Modified Distributions.
- y. The Modified Distributions are not part of a plan or series of related transactions within the meaning of section 355(e) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote or stock possessing 50 percent or more of the total value of all classes of stock of Distributing, Controlled 1, or Controlled 2.

PLR-115913-04

- z. Neither Distributing, FSub1, nor Controlled 2 is a passive foreign investment company as defined in section 1297(a). Distributing, FSub1, and Controlled 2 will each become a CFC (as defined in section 957) as a result of the Domestication.
- aa. Immediately before Modified Distribution 1, items of income, gain, loss, deduction, and credit (if any) will be taken into account as required by the applicable intercompany transaction regulations.
- bb. The transfer by Controlled 1 to C1Sub5 of approximately K percent of the common stock and all of the preferred stock of C1Sub6, and all of the stock of C1Sub7, solely in exchange for actual or constructive shares of C1Sub5 stock, followed by the conversions under State A law of C1Sub7 and C1Sub6 to SMLLCs disregarded as separate from C1Sub5 for tax purposes, will qualify as tax-free reorganizations defined in section 368(a)(1)(D) in which no gain or loss will be recognized.
- cc. The conversions under state law (or mergers or other transformation into SMLLCs) of C1Sub9, C1Sub10, C1Sub11, C1Sub12, C1Sub13, C1Sub14, and C1Sub18, will qualify as tax-free liquidations under sections 332 and 337 in which no gain or loss will be recognized.
- dd. The upstream mergers of C1Sub19, C1Sub20, C1Sub21, and C1Sub8 into C1Sub5, will qualify as tax-free liquidations under Sections 332 and 337 in which no gain or loss will be recognized.
- ee. Controlled 1 is not a United States real property holding corporation (as defined in section 897(c)(2)) and has not been a United States real property holding corporation during the five-year period ending on the date of Modified Distribution 1.
- ff. Distributing and Controlled 2 are, and will be, corporations within the meaning of section 7701(a)(3) after the Modified Distributions.
- gg. New Parent (as the sole shareholder of FSub3) will be a section 1248 shareholder with respect to each of Distributing and Controlled 2, within the meaning of Treas. Reg. section 1.367(b)-2(b), immediately before and immediately after the Modified Distributions.
- hh. The notice requirements of Treas. Reg. section 1.367(b)-1(c)(1) will be met for the Modified Distributions.

PLR-115913-04

- ii. Following Modified Distribution 1, each shareholder of Distributing who is a United States shareholder, as defined in section 951(b), will compute its predistribution and postdistribution amount with respect to Distributing and Controlled 1, as defined under Treas. Reg. sections 1.367(b)-5(e)(1) and (2). To the extent the predistribution amount exceeds the postdistribution amount with respect to either Distributing or Controlled 1, the United States shareholder will make basis adjustments and recognize income (if any), as required under the applicable Treasury regulations.
- jj. Following Modified Distribution 2, each shareholder of Distributing who is a United States shareholder, as defined in section 951(b), will compute its predistribution and postdistribution amount with respect to Distributing and Controlled 2, as defined under Treas. Reg. sections 1.367(b)-5(e)(1) and (2). To the extent the predistribution amount exceeds the postdistribution amount with respect to either Distributing or Controlled 2, the United States shareholder will make basis adjustments and recognize income (if any), as required under the applicable Treasury regulations.

Based solely on the information submitted and the representations set forth above, we rule that Ruling 1 contained in the Prior Letter Ruling is withdrawn and the following ruling is substituted therefor:

- 1. Step (i) will be treated as if Distributing distributed all of its Controlled 1 common stock to New Parent (Modified Distribution 1) and all of its Controlled 2 common stock to New Parent (Modified Distribution 2).

In addition, we rule that the above changes will have no effect on the rulings contained in the Prior Letter Ruling (restated below) and such rulings will remain in full force and effect:

- 2. No gain or loss will be recognized by Distributing upon the Modified Distributions (section 355(c)(1)).
- 3. No gain or loss will be recognized by (and no amount is included in the income of) New Parent upon the receipt of the stock of Controlled 1 and Controlled 2 (section 355(a)(1)), except as stated in Rulings 7 and 8.
- 4. The aggregate basis of the Distributing, Controlled 1, and Controlled 2 shares in the hands of New Parent immediately after the Modified Distributions will be the same as the aggregate basis of the Distributing stock in the hands of New Parent immediately before the Modified Distributions, allocated between the Distributing, Controlled 1, and Controlled 2 stock in proportion to the fair market value of each in



PLR-115913-04

accordance with Treas. Reg. section 1.358-2(a)(2) (section 358(a), (b) and (c)).

5. The holding period of the Controlled 1 and Controlled 2 stock in the hands of New Parent will include the holding period of the Distributing shares with respect to which the Modified Distributions will be made, provided the Distributing shares are held as a capital asset by New Parent on the date of the Modified Distributions (section 1223(1)).
6. Modified Distribution 1 will be a distribution to which sections 1.367(b)-1(c), 1.367(b)-5(a), 1.367(b)-5(c), and 1.367(b)-5(f) apply. If New Parent's postdistribution amounts, as defined in section 1.367(b)-5(e)(2), with respect to Distributing or Controlled 1 is less than New Parent's predistribution amounts, respectively, as defined in section 1.367(b)-5(e)(1), with respect to Distributing or Controlled 1, New Parent's basis in such stock immediately after Modified Distribution 1 must be reduced by the amount of the difference. However, New Parent's basis in its stock must not be reduced below zero, and to the extent the foregoing reduction would have reduced basis below zero, New Parent must instead include such amount in income as a deemed dividend from such corporation. If New Parent reduces its basis in the stock of Distributing or Controlled 1 (or has an inclusion with respect to such stock), New Parent shall increase its basis in the stock of the other corporation to the extent provided in section 1.367(b)-5(c)(4).
7. Modified Distribution 2 will be a distribution to which sections 1.367(b)-1(c), 1.367(b)-5(a), 1.367(b)-5(c) and 1.367(b)-5(f) apply. If New Parent's postdistribution amounts, as defined in section 1.367(b)-5(e)(2), with respect to Distributing or Controlled 2 is less than New Parent's predistribution amounts, respectively, as defined in section 1.367(b)-5(e)(1), with respect to Distributing or Controlled 2, New Parent's basis in such stock immediately after Modified Distribution 2 must be reduced by the amount of the difference. However, New Parent's basis in its stock must not be reduced below zero, and to the extent the foregoing reduction would have reduced basis below zero, New Parent must instead include such amount in income as a deemed dividend from such corporation. If New Parent reduces its basis in the stock of Distributing or Controlled 2 (or has an inclusion with respect to such stock), New Parent shall increase its basis in the stock of the other corporation to the extent provided in section 1.367(b)-5(c)(4).

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code and Income Tax Regulations other than those

PLR-115913-04

expressed in the Prior Letter Ruling, or about 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 ruling or those rulings set forth in Prior Letter Ruling. 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 in which the transaction covered by this ruling letter is consummated.

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

Pursuant to the power of attorney on file in this office, a copy of this ruling letter will be forwarded to the taxpayer and another authorized representative.

Sincerely,  
Associate Chief Counsel (Corporate)

By: \_\_\_\_\_  
Victor L. Penico  
Senior Counsel, Branch 1

cc: