

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:CORP:4-PLR-115711-00  
Date:  
December 27, 2000

Parent =

Sub 1 =

Distributing =

Controlled =

Industry AB =

Business A =

Business B =

Business C =

Business D =

Agreement E =

Government Agency =

Rules =

Date G =

Date H =

Date I =

b =

c =

d =

This letter responds to your August 11, 2000 request for rulings on certain

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federal income tax consequences of a proposed transaction. Additional information was requested and submitted in a letter dated November 22, 2000. The information submitted for consideration is summarized below.

### **Summary of Facts**

Parent is the publicly held parent of a consolidated group. Distributing, a wholly owned subsidiary of Parent, conducts Business A, Business B, Business C, and Business D, all of which are encompassed within Industry AB. Parent also owns all of the outstanding stock of Sub 1. Sub 1 was formed on Date G and currently constructs and acquires assets used in Business B and Business C.

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

Distributing is subject to regulation by Government Agency. Government Agency has promulgated new rules relating to Industry AB by enacting the Rules. Under the Rules, Business A will remain regulated, but Business B and Business C will be opened to competition. The Rules order that all competitive businesses operated by Distributing be separated from its noncompetitive businesses. The Rules do not permit such a separation to be effected by a transfer to a subsidiary of Distributing.

On Date H, Distributing and Government Agency executed Agreement E, which states how Distributing will separate its regulated business from its nonregulated businesses. Agreement E specifically requires Distributing to transfer its Business B and Business C assets to respective direct subsidiaries of Parent by Date I.

As described below, Distributing proposes to divest itself of Business B. The divestiture of Business C will occur at a later date (no later than Date I).

### **Proposed Transaction**

To effect the separation of Business B, Distributing has proposed the following series of steps (collectively, the "Proposed Transaction"):

(i) Distributing will transfer its Business B assets to newly formed Controlled in exchange for all of Controlled's stock and the assumption by Controlled of the liabilities associated with the Business B assets (the "Transfer");

(ii) Distributing will distribute all of the stock of Controlled to Parent (the "Distribution"); and

(iii) Controlled will merge with and into Sub 1 (the "Merger").

## Representations

The taxpayer has made the following representations regarding the Transfer and Distribution:

(a) The indebtedness owed by Controlled to Distributing after the distribution of Controlled's stock will not constitute stock or securities.

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

(c) The five years of financial information submitted on behalf of Distributing is representative of Distributing'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.

(d) The gross assets of the trade or business conducted by Distributing that will be relied upon to satisfy the active trade or business requirement of section 355(b) of the Internal Revenue Code have a fair market value, in the aggregate, that will not be less than five percent of the total fair market value of the gross assets of Distributing.

(e) The five years of financial information submitted 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.

(f) Following the Distribution, Distributing and Controlled (or its successor), will each continue the active conduct of their respective businesses, independently and with their own separate employees, except that during a period of transition they plan to share the services of b. Additionally, Distributing and Controlled (or its successor) will share the services provided by c as well as the services of d ("Representation (f)").

(g) The gross assets of the trade or business conducted by Controlled that will be relied upon to satisfy the active trade or business requirement of section 355(b) have a fair market value, in the aggregate, that will not be less than five percent of the total fair market value of the gross assets of Controlled.

(h) The Distribution is motivated in whole or substantial part by the corporate business purpose of separating its regulated and nonregulated businesses as required by the Rules.

(i) Except for the Merger, there is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled (or its successor) after the Proposed Transaction.

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(j) There is no plan or intention by either Distributing or Controlled (or its successor), 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 section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

(k) There is no plan or intention to liquidate either Distributing or Controlled, to merge Distributing with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Proposed Transaction, except in the ordinary course of business and except as provided in Agreement E.

(l)(1) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject; and

(2) The liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

(m) Distributing did not accumulate its receivables or make an extraordinary payment of its payables in anticipation of the distribution of Controlled.

(n) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution, except for potential debt arising from the shared services referred to above in Representation (f).

(o) 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 Treas. Reg. §§ 1.1502-13 and 1.1502-14 of the Income Tax Regulations as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; Treas. Reg. § 1.1502-13 as published in T.D. 8597).

(p) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled (or its successor), will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(q) No two parties to the Proposed Transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

(r) The Distribution is 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 either Distributing or Controlled stock entitled to vote, or stock possessing 50 percent or more of the total value of shares of all classes of either Distributing or Controlled stock.

(s) To the best of its knowledge and belief, the Merger will qualify as a

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reorganization under section 368(a)(1)(A).

### **Rulings**

Based solely on the facts submitted and representations made, we rule as follows on the Proposed Transaction:

(1) The Transfer and Distribution will constitute a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be a party to a reorganization within the meaning of section 368(b).

(2) No gain or loss will be recognized by Distributing on the Transfer (sections 361(a) and 357(a)).

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

(4) Controlled's basis in each of the Business B assets received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the Transfer (section 362(b)).

(5) The holding period for each asset received by Controlled from Distributing will include the period during which Distributing held such asset (section 1223(2)).

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

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

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

(9) Proper allocation of Distributing's earnings and profits will be made under Treas. Reg. §§ 1.312-10(a) and 1.1502-33.

### **Caveats**

No opinion is expressed about the tax treatment of the Proposed Transaction under 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, no opinion is expressed concerning: (i) whether the Merger qualifies as a reorganization under section 368(a)(1)(A), or (ii) the section 358 basis allocation with respect to the Distribution.

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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.

### **Procedural Statements**

This ruling letter 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 affected by the Proposed Transaction should attach a copy of this ruling letter to such taxpayer's federal tax return for the taxable year in which the Proposed Transaction is completed.

Under a power of attorney on file in this office a copy of this ruling letter is being sent to your authorized representative.

Sincerely,  
Associate Chief Counsel (Corporate)  
By: Stephen P. Fattman  
Assistant to the Chief  
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