

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP-PLR-130094-02
Date:
October 9, 2002

Legend

System =

Act =

Distributing =

Corp X =

Corp Y =

Corp Z =

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Acquiring =

A =

B =

C =

D =

E =

F =

G =

Business X =

Business Y =

Territory X =

Territory Y =

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District L =

j percent =

k percent =

Dear :

This letter responds to your request dated May 29, 2002, for rulings on certain federal income tax consequences of a proposed transaction. The information submitted is summarized below.

The information provided indicates that Distributing is an accrual basis, federally chartered corporation. Distributing is a member-owned cooperative engaged in making loans and performing financially related services to, and exercising supervisory authorities over, As operating in District L. Distributing is exempt from Federal income taxation under section 501(c)(1) of the Internal Revenue Code of 1986, as amended (the "Code").

As a B, Distributing is a member institution of the System, a network of federally chartered instrumentalities regulated and supervised by E, a federal agency. The outstanding classes of Distributing common stock are owned by Corp X and Corp Y, which are As and which provide credit and financially related services to Gs in their respective territories. The outstanding participation certificates are owned by an unrelated E. Corp X holds j percent of the total voting power and Corp Y holds k percent of the total voting power of Distributing. Pursuant to the bylaws of Distributing, Corp X and Corp Y elect an equal number of directors, and those directors appoint additional directors.

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

Information has been submitted that demonstrates that Corp X and Corp Y have fundamental disagreements as to the management and strategic direction of the businesses of Distributing. Over the past year, it became apparent to Distributing's board of directors that Corp X and Corp Y differ in the types of credit and services they seek from Distributing and how such credit and services should be delivered. These differences are due, in part, to differences in the territories they serve. Territory X,

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which is served by Corp X, and Territory Y, which is served by Corp Y, contain substantially different operations and Gs. Corp X and Corp Y each desire credit and services from Distributing that are tailored to suit their respective marketplaces. In addition, Corp X and Corp Y have different philosophies on how risk factors should be reflected in pricing from Distributing. In sum, Distributing believes it is difficult to serve the varying, and at times conflicting, needs of Corp X and Corp Y, while maintaining costs at levels comparable to other Bs.

Corp X and Corp Y wish to separate the business of Distributing into two territory-based businesses, Business X and Business Y. This separation will enable Corp X and Corp Y to receive credit and services that are more tailored to the needs of their respective members and marketplaces than the credit and services Distributing is providing.

To achieve this result, Distributing has proposed that Acquiring, which is a C and which has a membership base which shares characteristics similar to those of the members of Corp X, acquire the Business X assets. Thereafter, it is proposed that Distributing will merge with and into Corp Z.

Distributing, Acquiring, Corp X, and a newly created corporation (“Controlled”) will enter into an agreement (the “Agreement”) under which Distributing will separate Business X from Business Y and Acquiring will acquire the Business X assets. The proposed transactions will be accomplished through the following steps.

- (i) Distributing will organize Controlled. Controlled will be a D. Controlled will have one class of voting common stock.
- (ii) Distributing will transfer its Business X assets to Controlled in exchange for all of Controlled’s stock and the assumption by Controlled of the liabilities associated with Business X (the “Contribution”).
- (iii) The Agreement provides that Distributing is to distribute all of its Controlled stock to Corp X in redemption of all of the Distributing stock held by Corp X (the “Distribution”), and grants Corp X the right to cause the Controlled shares to be transferred directly by Distributing to Acquiring. Corp X will exercise this right and, as a result, at Corp X’s direction, Distributing will transfer the stock of Controlled directly to Acquiring. Pursuant to the Agreement and as part of the Distribution, Distributing will retire and cancel all of the Distributing stock held by Corp X.
- (iv) Pursuant to the Agreement, Acquiring will issue its voting common shares (the “Acquiring Shares”) to Corp X in exchange for the Controlled stock it will receive in step iii (the “Exchange”).

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- (v) Controlled will liquidate in accordance with the terms of the Agreement distributing all of its assets to Acquiring (the "Liquidation").

Following the transactions in steps (i) - (v) above, Distributing will merge with and into Corp Z (the "Merger"). Pursuant to the Merger, all of the common stock of Distributing held by Corp Y will be converted into common stock of Corp Z.

The following representations are submitted in connection with the proposed Contribution and Distribution:

- (a) The total adjusted basis and the fair market value of the Business X assets to be transferred to Controlled by Distributing pursuant to the Contribution will, in each instance, be equal to or exceed the sum of the liabilities to be assumed (as determined under section 357(d)) by Controlled plus any liabilities to which the transferred assets are subject.
- (b) Controlled (and Acquiring, as Controlled's successor) is expected to satisfy only the liabilities associated with Business X.
- (c) The liabilities to be assumed (as determined under section 357(d)) by Controlled pursuant to the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- (d) The fair market value of the Controlled stock treated as received by Corp X in the Distribution will be approximately equal to the fair market value of the Distributing stock surrendered by Corp X in the Distribution.
- (e) Distributing, Controlled, and Corp X will pay their respective expenses, if any, incurred in connection with the Contribution and Distribution.
- (f) No part of the Controlled stock to be distributed by Distributing will be received, actually or constructively, by Corp X as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (g) The five years of financial information submitted reflecting Distributing's Business X and Business Y is representative of its present operations and, with regard to each of these businesses, there have been no substantial operational changes since the date of the last financial statements submitted.
- (h) Following the Distribution, the Exchange, the Liquidation, and the Merger, Corp Z (as successor to Distributing) and Acquiring (as successor to Controlled) will each continue the active conduct of its business, independently and with its separate employees. Following the Distribution

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and the Merger, Corp Z (as Distributing's successor) will continue the active conduct of Business Y and Acquiring (as Controlled's successor) will continue the active conduct of Business X in substantially the same manner as such business had been conducted by Distributing.

- (i) Immediately after the Distribution, the gross assets of Business Y will have a fair market value equal to or greater than five percent of the fair market value of all of Distributing's gross assets.
- (j) Immediately after the Distribution, the gross assets of Business X will have a fair market value equal to or greater than five percent of the fair market value of all of Controlled's gross assets.
- (k) The Distribution is being undertaken for the corporate business purposes described above. The Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (l) Corp X has no plan or intention to sell, exchange, transfer by gift, or otherwise dispose of any stock in Distributing, Controlled, or Acquiring after the Distribution, except in connection with the Exchange.
- (m) There is no plan or intention by Distributing, Corp Z, Controlled, or Acquiring, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distribution.
- (n) There is no plan or intention to liquidate Distributing, Corp Z, Controlled, or Acquiring, to merge any of these corporations with any other corporation, or to sell or otherwise dispose of any of the assets of any of these corporations subsequent to the Distribution, except in connection with the Liquidation and the Merger.
- (o) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the proposed transaction.
- (p) No indebtedness will exist between Distributing (or its successor, Corp Z) and Controlled (or its successor, Acquiring) at the time of, or subsequent to, the Distribution, except for indebtedness arising in the ordinary course of business.
- (q) Payments made in connection with all continuing transactions, if any, between Corp Z (as successor to Distributing), on the one hand, and Acquiring (as successor to Controlled), on the other hand, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

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- (r) None of Distributing, Corp Z, Controlled, or Acquiring is an investment company as defined in section 368(a)(2)(F)(iii) and (iv).
- (s) The Distribution will be subject to section 355(e), and therefore the stock of Controlled will not be treated as qualified property for purposes of section 355(c)(2) and section 361(c)(2).

The following representations are submitted in connection with the proposed Exchange and Liquidation:

- (t) The fair market value of the Acquiring stock to be received by Corp X in the Exchange will be approximately equal to the fair market value of the Controlled stock transferred to Acquiring in the Exchange.
- (u) Except as described in the Contribution and Distribution (1) there is no plan or intention for Acquiring, or any person related (as defined in section 1.368-1(e)(3) of the Regulations) to Acquiring, to acquire, with consideration other than Acquiring stock, either directly or through any transaction, agreement, or arrangement with any other person shares of Acquiring stock transferred in the Exchange; (2) as of the date of the proposed transactions, neither Distributing nor Controlled will have made any distributions with respect to its stock (other than ordinary, regular dividend distributions), either directly or through any transaction, agreement, or arrangement with any other person, and neither Distributing nor Controlled will have redeemed any of its stock in connection with the Exchange; and (3) as of the date of proposed transactions, neither Acquiring, nor any person related (as defined in section 1.368-1(e)(3) of the Regulations) to Acquiring, will have acquired with consideration other than Acquiring stock any stock of Distributing or Controlled in connection with the proposed transactions, either directly or through any transaction, agreement, or arrangement with any other person.
- (v) Acquiring 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 Controlled immediately prior to the Exchange and the Liquidation.
- (w) Acquiring has no plan or intention to reacquire any of its stock issued in the transaction.
- (x) Acquiring has no plan or intention to sell or otherwise dispose of any of the assets of Controlled acquired in the transaction, except for dispositions made in the ordinary course of business.
- (y) The liabilities of Controlled assumed by Acquiring and the liabilities to which the transferred assets of Controlled are subject were incurred by

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- Controlled (or its predecessor, Distributing) in the ordinary course of its business.
- (z) Following the transaction, Acquiring will continue the historic Business X or use a significant portion of the assets of such historic business in a business.
 - (aa) Acquiring, Controlled, and Corp X will pay their respective expenses, if any, incurred in connection with the Exchange and Liquidation.
 - (bb) There will be no intercorporate indebtedness existing between Acquiring and Controlled that was or will be issued, acquired, or settled at a discount.
 - (cc) Acquiring does not own, directly or indirectly, nor has it owned during the past five years, directly or indirectly, any stock of Controlled (or its predecessor, Distributing).
 - (dd) The fair market value of the assets of Controlled transferred to Acquiring will equal or exceed the sum of the liabilities assumed by Acquiring (determined under section 357(d)), plus the amount of liabilities, if any, to which the transferred assets are subject.
 - (ee) Controlled is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of section 368(a)(3)(A).

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

- (1) The proposed transactions will be treated as if (i) Distributing contributed Business X to Controlled (*i.e.*, the Contribution), (ii) Distributing distributed 100% of the stock of Controlled to Corp X in retirement of all of the Distributing stock held by Corp X (*i.e.*, the Distribution); (iii) Controlled transferred all of its assets and liabilities to Acquiring solely in exchange for the Acquiring Shares (*i.e.*, the Exchange and Liquidation); and (iv) Controlled liquidated, distributing the Acquiring Shares to Corp X (*i.e.*, the Liquidation). See Rev. Rul. 77-191, 1977-1 C.B. 94, Rev. Rul. 70-224, 1970-1 C.B. 79, Rev. Rul. 67-274, 1967-2 C.B. 141, Rev. Rul. 64-73, 1964-1 C.B. 142.
- (2) No gain or loss will be recognized by Controlled upon the receipt of the assets and liabilities of Business X in exchange for Controlled stock (section 1032(a)).
- (3) The basis of each asset received by Controlled in the Contribution will

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equal the basis of that asset in the hands of Distributing immediately before the Contribution (section 362(b)).

- (4) The holding period of each asset received by Controlled in the Contribution will include the period during which Distributing held the asset (section 1223(2)).
- (5) No gain or loss will be recognized by Corp X as a result of the Distribution (section 355(a)).
- (6) The aggregate basis of the Controlled shares in the hands of Corp X after the Distribution will be the same as the basis of the Distributing shares in the hands of Corp X immediately before the Distribution (section 358(a)(1)).
- (7) The holding period of the Controlled shares received by Corp X in the Distribution will include the holding period of the Distributing shares with respect to which the Distribution will be made, provided that such Distributing shares are held as capital assets on the date of the Distribution (section 1223(1)).
- (8) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under section 1.312-10(a) of the Regulations.
- (9) The Exchange and Liquidation will qualify as a reorganization within the meaning of section 368(a)(1)(C) of the Code. Controlled and Acquiring will each be a "party to a reorganization" within the meaning of section 368(b).
- (10) No gain or loss will be recognized by Controlled upon the transfer of substantially all of its assets to, and the assumption of its liabilities by, Acquiring in the Exchange or on the distribution of the Acquiring Shares to Corp X in the Liquidation (section 357(a) and sections 361(a) and (c)).
- (11) No gain or loss will be recognized by Acquiring upon the acquisition of substantially all of the assets and assumption of the liabilities of Controlled in the Exchange (section 1032(a)).
- (12) No gain or loss will be recognized by Corp X upon the receipt of the Acquiring Shares in the Exchange and Liquidation (section 354(a)).
- (13) The basis of the assets of Business X in the hands of Acquiring will be the same as the basis of those assets in the hands of Controlled immediately prior to the Exchange (section 362(b)).

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- (14) The holding period of the assets of Business X in the hands of Acquiring will include the period during which those assets were held by Controlled and by Distributing (section 1223(2)).
- (15) The basis of the Acquiring Shares received by Corp X will be the same as the basis of the Controlled stock surrendered in exchange therefor (section 358(a)(1)).
- (16) The holding period of the Acquiring Shares received by Corp X will include the period during which Corp X held the Controlled stock surrendered in the Exchange and Liquidation, provided the Controlled stock is held as a capital asset on the date of the Distribution (section 1223(1)).
- (17) Pursuant to section 381(a) and section 1.381(a)-1 of the Regulations, Acquiring will succeed to and take into account the items of Controlled described in section 381(c), subject to the conditions and limitations specified in sections 381(b), 381(c), 382, 383, and 384 and the regulations thereunder.
- (18) As provided by section 381(c)(2) and section 1.381(c)(2)-1 of the Regulations, Acquiring will succeed to and take into account the earnings and profits, or deficit in earnings and profits, of Controlled as of the close of the date of the Exchange and the Liquidation. Any deficit in earnings and profits of Controlled or Acquiring will be used only to offset the earnings and profits of Acquiring accumulated after the Exchange and the Liquidation.
- (19) Corp X's stock shall not be treated as qualified property for purposes of section 355(c)(2) or section 361(c)(2) (section 355(e)).

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.

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.

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.

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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.

Sincerely,

Charles M. Levy

Charles M. Levy
Reviewer, Branch 2
Office of Associate Chief Counsel
(Corporate)