

Internal Revenue Service

Number: **200505009**

Release Date: 2/4/05

Index Number: 355.01-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:B06

PLR-133908-04

Date:

October 21, 2004

Legend

Parent =

Distributing =

Controlled =

PSub =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

Sub 7 =

Sub 8 =

Sub 9 =

Sub 10 =

Partnership =

HC =

\$a =

\$b =

Note 1 =

Transfer

Steps =

Country X =

Business X =

Business Y =

Y Services =

Agreements =

a% =

b% =

c% =

d% =

e% =

f% =

g% =

h% =

i% =

j% =

k% =

l%

Dear

This letter responds to a letter from your authorized representatives dated June 16, 2004 requesting rulings under I.R.C. section 355 for the transaction described below. Additional information was submitted in letters dated July 9, July 23, August 13, August 20, September 3, September 10, September 22, and October 21, 2004. The information submitted is summarized below.

The rulings contained in this letter are based on 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 rulings. Verification of the information, representations, and other data may be required as part of the audit process. Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the proposed transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) and § 1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see section 355(e)(2)(A)(ii) and § 1.355-7T).

Parent is a Country X corporation that owns all of the stock of Distributing. Distributing is a Country X corporation that is engaged in Business X. Distributing owns i% of the stock of Controlled and Sub 10. Distributing owns k%, and Sub 10 owns l%, of the stock of Sub 6. Distributing also owns f% of the stock of Sub 2 and stock in Sub 3 which represents g% of the outstanding stock and h% of the vote.

Controlled is a domestic corporation that is the common parent of an affiliated group of corporations filing a consolidated Federal income tax return. Controlled has outstanding two classes of stock, Class A and Class B. The Class A stock represents approximately d% of the vote and value of the Controlled stock and the Class B stock represents approximately e%. Currently, each share of stock, whether Class A or Class B, is entitled to one vote per share. Controlled's lower tier subsidiaries are engaged in Business Y. Controlled's lower tier subsidiaries include, among other subsidiaries, Sub 7, Sub 8, Sub 9 (each i% owned by a Controlled consolidated group member) and Sub 4 (j% owned by a Controlled consolidated group member).

Sub 1 is also a lower tier subsidiary of Controlled. Each corporation in the chain between Controlled and Sub 1, which includes Sub 5, is wholly owned by the next higher tier corporation. Currently, all of Sub 1's employees are employed by PSub, the parent of Sub 1. Sub 1 provides Y Services to certain related parties, including both members of the Controlled consolidated group and non-consolidated affiliates of the Parent group. Sub 1 provides these services to its consolidated affiliates at cost and to its non-consolidated affiliates on a cost plus basis.

Business X is regulated. If Distributing were to no longer own its investments in subsidiaries engaged in Business Y, Parent's regulatory capital ratio would be higher. This would enable Parent to avoid adverse regulatory and ratings impacts from, and to

reduce the cost of capital for, the acquisition of new businesses. Accordingly, Parent proposes to cause Distributing to distribute its Controlled stock.

Prior to undertaking the distribution described below, the following preliminary transactions will occur:

- 1) Controlled's Class A stock will be recapitalized to provide each Class A share two votes per share. After the recapitalization, the Class A shares will possess, in the aggregate, a% of the total voting power and b% of the value of Controlled.
- 2) (a) PSub will transfer the employees performing the Y Services to Sub 1; (b) Sub 1 will be distributed up the chain of wholly owned corporations until it becomes a subsidiary of Controlled; and (c) Sub 1 will convert to an LLC that is a disregarded entity for Federal income tax purposes.
- 3) Parent will form HC, a Country X corporation.

To effectuate the distribution, Distributing will transfer Controlled's Class A shares to HC using the following butterfly mechanism:

- 1) Parent will transfer to HC up to c% of the issued and outstanding common stock of Distributing in consideration for HC's issuance to Parent of additional common stock.
- 2) Distributing will transfer to HC a number of the Controlled Class A shares, such that the aggregate fair market value of the shares so transferred by Distributing to HC is equal to the aggregate fair market value of the common shares of Distributing transferred by Parent to HC as described in step 1 above. Distributing's transfer of Controlled Class A shares to HC will be in consideration for HC's issuance to Distributing of spin-off preferred shares.

Upon completion of steps 1 and 2, HC will have acquired common shares of Distributing, and Distributing will own spin-off preferred shares, which are equal in value. HC will also own a portion of the Controlled Class A shares.

- 3) Distributing will purchase for cancellation its common stock held by HC in consideration for Distributing's issuance to HC of a non-interest bearing demand note ("D-HC Demand Note") having a principal amount and fair market value equal to the fair market value of such shares. HC will redeem its spin-off preferred shares in consideration for HC's issuance to Distributing of a non-interest bearing demand note ("HC Demand Note") having a principal amount and fair market value equal to the redemption amount of such shares. The D-HC Demand Note will be set off against the HC Demand Note in full satisfaction of the obligations under each of these notes and these notes will be cancelled.

- 4) On the completion of steps 1 through 3, Parent will continue to own 100% of the Distributing common shares and Controlled will be owned by both Distributing and HC. Steps 1 through 3 will be repeated until Controlled is wholly owned by HC.

After steps 1 through 4, Controlled will be a wholly-owned subsidiary of HC and it will no longer be a subsidiary of Distributing. For Federal income tax purposes, Parent intends to treat these steps as Distributing's distribution of all of its Controlled Class A shares to Parent, followed by Parent's contribution of those shares to HC.

Additionally, in the view of the taxpayer, in substance, Controlled owes a debt, secured by shares of preferred stock in Sub 5, to Distributing ("Note 1") that Distributing will transfer to HC pursuant to the Transfer Steps. Also in the view of the taxpayer, in substance, Distributing will distribute Note 1 to Parent and Parent will contribute Note 1 to HC.

As part of a larger restructuring, various other events or transactions (i.e., other than the distribution of the Controlled Class A stock and Note 1) will also occur in which:

(a) Distributing will transfer to HC the Controlled Class B stock in steps that, in the view of the taxpayer, in substance, involve Distributing's exchange of the Controlled Class B stock for a note of Parent, and Parent's contribution of the Controlled Class B stock to HC; (b) Distributing will transfer to HC, through other butterfly transactions, all the stock in Sub 2 and in Sub 3 that it owns, and the butterfly transaction for Sub 2 will include a transfer by HC to Distributing of \$a cash received from Parent; (c) a debt in the amount of \$a owed by Distributing to Sub 7 will be repaid by Distributing and the proceeds reloaned by that subsidiary to Parent; and (d) with prior regulatory approval, Parent will cancel debt owed to it by Distributing in the amount of \$b and Distributing will issue additional common shares to Parent. Distributing will continue to guarantee two classes of bonds issued by Sub 7 to the public and a note issued by Sub 8 to Partnership. Distributing will also continue to guarantee interest payments on a note owed by Sub 4 to PSub. Specifically, Distributing will pay to PSub the difference between Sub 4's interest payments on the debt it owes to PSub and the yield PSub receives in loans to nonaffiliates.

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

- (a) No intercorporate debt will exist between Distributing and its affiliates, on the one hand, and Controlled and its affiliates, on the other hand, at the time of, or subsequent to, the distribution, other than: (i) Note 1; (ii) Sub 6 will continue to hold a note in Sub 9 and two notes in PSub; (iii) debt incurred in the ordinary course of business; and (iv) Distributing may, through its interest in a controlled entity, hold Agreements of PSub. None of the debt will constitute stock or a security for Federal income tax purposes.

- (b) Payments made in connection with all continuing transactions between Distributing and Controlled and their subsidiaries will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's-length.
- (c) No part of the consideration to be distributed by Distributing will be received by a shareholder of Distributing 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 Distributing is representative of the corporation'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.
- (e) The five years of financial information submitted on behalf of Sub 1 is representative of its present operations, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) Following the distribution, Distributing and Controlled will each continue the active conduct of its respective business, independently and with its separate employees, except that Controlled will provide Y Services to Distributing.
- (g) The distribution of Controlled will be carried out for the following corporate business purpose:
 - The proposed corporate restructuring will increase Parent's regulatory capital ratio. This will help Parent to avoid adverse regulatory and ratings impacts from, and to reduce the cost of capital for, the acquisition of new businesses. Parent will thereby avoid competitive disadvantages it now faces in pursuing its growth strategy.
 - The distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (h) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (i) The distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7T) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50 percent or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled (including any predecessor or successor).
- (j) For purposes of section 355(d), immediately after the distribution, no person (determined after applying the aggregation rules of section 355(d)(7)) will hold

stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing stock that was either (i) 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 distribution or (ii) attributable to distributions 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 distribution.

- (k) For purposes of section 355(d), immediately after the distribution, no person (determined after applying the aggregation rules of section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled stock that was either (i) 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 distribution or (ii) attributable to distributions 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 the distribution.
- (l) Distributing is not a passive foreign investment corporation, as defined in section 1297(a).
- (m) Distributing is not a controlled foreign corporation (as defined in section 957), and will not be a controlled foreign corporation before or after the distribution.
- (n) Controlled will not have been a United States real property holding corporation ("USRPHC") as defined in section 897(c)(2) at any time during the five-year period ending on the date of the distribution and will not be a USRPHC immediately after the distribution.
- (o) Parent is not a passive foreign investment corporation, as defined in section 1297(a).
- (p) Parent is not a controlled foreign corporation (as defined in section 957), and will not be a controlled foreign corporation before or after the distribution.
- (q) Parent's transfer to HC of shares of Controlled Class A stock after the distribution is a transfer that qualifies under section 351(a).
- (r) The recapitalization of the Controlled Class A shares, to provide each Class A share the right cast two votes on all matters on which Controlled shareholders are entitled to vote, will constitute a reorganization under section 368(a)(1)(E).

- (s) There is no plan or intention for Controlled to realign its voting structure after the distribution.
- (t) The conversion of Sub 1 from a corporation into a limited liability company treated as a disregarded entity for Federal income tax purposes will constitute a complete subsidiary liquidation pursuant to section 332.
- (u) After its conversion to a limited liability company, there is no plan or intention for Sub 1 to elect to be classified as a corporation for Federal income tax purposes.

Based solely on the information submitted and the representations made, we have concluded that:

- (1) Steps 1-4 above, by which Distributing will transfer its Controlled Class A stock to HC, will be treated, for Federal income tax purposes, as if Distributing distributed the Controlled Class A stock to Parent, followed by Parent's transfer of the Controlled Class A stock to HC. Rev. Rul. 83-142, 1983-2 C.B. 68; Rev. Rul. 77-191, 1977-1 C.B. 94; Rev. Rul. 73-427, 1973-2 C.B. 301; and Rev. Rul. 67-448, 1967-2 C.B. 144. In addition, provided that, in substance, Note 1 is a debt of Controlled that Controlled owes to Distributing, and that, in substance, Distributing will distribute Note 1 to Parent and Parent will contribute Note 1 to HC, Note 1 will be treated as provided in rulings (2) and (3) below.
- (2) No gain or loss will be recognized to (and no amounts will be included in the income of) Parent upon the receipt of the Controlled Class A stock and Note 1 distributed by Distributing, other than an amount equal to the fair market value of Note 1 which will be treated as a distribution of property to which section 301 applies. Sections 355(a)(1) and 356(b) and § 1.356-2(a).
- (3) No gain or loss will be recognized by Distributing on its distribution of the Controlled Class A stock and Note 1 to Parent, except that Distributing will recognize gain, if any, as if Distributing had sold Note 1 to Parent at its fair market value. Sections 355(c) and 311(b).
- (4) The holding period of the Controlled Class A stock received by Parent will include the holding period of the Distributing stock with respect to which the distribution will be made, provided that the Distributing stock is held as a capital asset on the date of exchange. Section 1223(1).

No opinion is expressed about the tax treatment of the proposed transactions 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 transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

- (i) whether the distribution satisfies the business purpose requirement of § 1.355-2(b);
- (ii) whether the proposed transaction is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see section 355(a)(1)(B) and § 1.355-2(d));
- (iii) whether the distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under section 355(e)(2)(A)(ii);
- (iv) the application of section 482 to the services, including Y Services, provided by Sub 1 or Controlled to its affiliates or other related parties;
- (v) the basis of the Controlled Class A stock in the hands of Parent (or HC);
- (vi) the allocation of earnings and profits between Distributing and Controlled under section 367(b);
- (vii) the characterization of the events or transactions surrounding the transfer of the Controlled Class B stock and the Federal income tax consequences thereof, including whether, in substance, Distributing exchanged the Controlled Class B stock for a note of Parent;
- (viii) the characterization of the events or transactions surrounding the creation of Note 1, as well as the characterization of Note 1 (including the characterization of the contractual arrangement and the transfer agreement pertaining thereto) and the Transfer Steps, and the Federal income tax consequences thereof, including whether, in substance, the events or transactions resulted in a debt that Controlled owed to Distributing and in Distributing holding the preferred stock of Sub 5 as security for that debt;
- (ix) the characterization for tax purposes and the Federal income tax consequences of the acquiring and holding of the Agreements of PSub by Distributing's controlled entity;
- (x) the characterization for tax purposes and the Federal income tax consequences of Distributing's guarantee of the bonds issued by Sub 7, the note issued by Sub 8, and the interest payments on the note issued by Sub 4 to PSub; or
- (xi) the characterization for tax purposes and the Federal income tax consequences of the other transactions, events, or interests described in this letter (i.e., other than the distribution of the Controlled Class A stock and Note 1 that is the subject of this letter).

This ruling is directed only to the taxpayer 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.

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,

Mary E. Goode
Senior Counsel, Branch 6
Office of Associate Chief
Counsel (Corporate)