

Internal Revenue Service

Department of the Treasury

Index Number: 301.00-00, 332.00-00,
355.01-00, 368.05-00

Washington, DC 20224

Number: **199940003**
Release Date: 10/8/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP:4 PLR-121797-98
Date:
April 14, 1999

Distributing =

Sub 1 =

Sub 2 =

Sub 3 =

Partnership =

Controlled =

Business A =

Business B =

Period C =

Country D =

e =

f =

g =

h =

i =

j =

k =

Consultant =

We respond to your December 3, 1998 request for rulings on certain federal income tax consequences of a series of proposed transactions. Distributing and its affiliates were the subject of rulings on prior transactions during Period C (the "Prior Ruling Letters").

Summary of Facts

Publicly traded Distributing is the common parent of a consolidated group engaged in Business A. Distributing was formed during Period C as part of a transaction that qualified under § 355 of the Internal Revenue Code. Distributing or its predecessors have wholly owned, directly or indirectly, Sub 1, Sub 2, and Sub 3 for more than five years. Sub 1 and Sub 2 are domestic corporations. Sub 3 is a Country D corporation engaged in Business A. Sub 2 and Sub 3 together own an e percent interest in domestic Partnership.

Controlled, a domestic corporation, conducts Business B and has only Class A stock outstanding. This stock is owned f percent by Distributing, g percent by Sub 1, h percent by Partnership, and the rest by the public and other persons unrelated to Distributing. Distributing (or its predecessors) and its affiliates have owned i shares of Controlled stock for more than five years (the "Old Shares"). Distributing also owns warrants to acquire additional Controlled stock.

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

Because Business A and Business B are substantially different businesses, their present relationship creates managerial, systemic, and other problems. The managements of Distributing and Controlled have therefore decided, based on the advice of Consultant and other information, to separate Business A and Business B.

Proposed Transactions

To accomplish this separation, Distributing proposes the following series of transactions:

(i) Sub 1 will (a) transfer all of its assets except the Controlled stock to a newly formed domestic limited liability company (the "LLC") and (b) merge into Distributing under state law (the "Liquidation"). It is intended that the LLC be disregarded for U.S. federal tax purposes

(ii) The Old Shares will be converted into Class B shares of Controlled as follows: (a) Distributing will form a new State B corporation ("Transitory"), (b) Distributing will transfer the Old Shares to Transitory in exchange for all of the Transitory stock, and (c) Transitory will merge into Controlled in exchange for issuance of Class B shares to Distributing on a share-for-share basis (altogether, the "Recapitalization"). The Class B Shares will have the right to elect 80 percent of the Controlled Board of Directors and will represent j percent of the fair market value of Controlled.

(iii) Distributing will distribute the Controlled Class B Shares to the shareholders of Distributing pro rata (the "Distribution"). In lieu of fractional Controlled shares, the distribution agent will aggregate all such share interests, sell the aggregated shares, and remit the proceeds to the shareholders entitled to fractional shares.

(iv) Distributing and Partnership will sell their Controlled Class A shares and Controlled warrants as quickly as is feasible following the Distribution, either to third parties or to Controlled.

Before the Distribution, Controlled will have distributed k dollars in cash to the holders of its Class A and Class B shares pro rata (the "Prior Distribution").

Liquidation Representations

The taxpayer has submitted the following representations concerning the Liquidation:

(a) Distributing, on the date of adoption of the plan of liquidation, and at all times

until the final liquidating distribution is completed, will be the owner of 100 percent of the single outstanding class of Sub 1 stock.

(b) No shares of Sub 1 stock will have been redeemed during the three years preceding the adoption of the plan of complete liquidation of Sub 1.

(c) All distributions from Sub 1 to Distributing pursuant to the plan of complete liquidation will be made within a single taxable year of Sub 1.

(d) As soon as the first liquidating distribution has been made, Sub 1 will cease to be a going concern, and its activities will be limited to winding up its affairs, paying its debts, and distributing its remaining assets to Distributing.

(e) Sub 1 will retain no assets following the final liquidating distribution.

(f) Sub 1 will not have acquired assets in any nontaxable transaction within the past three years.

(g) No assets of Sub 1 have been, or will be, disposed of by either Sub 1 or Distributing (i) except as described herein, (ii) except for dispositions in the ordinary course of business, and (iii) except for dispositions occurring more than three years before adoption of the plan of liquidation.

(h) The liquidation of Sub 1 will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation ("Recipient") of any of the businesses or assets of Sub 1, if persons who hold, directly and indirectly, more than 20 percent in value of the Sub 1 stock also hold, directly or indirectly, more than 20 percent in value of the stock in Recipient. For this representation, ownership will be determined by applying the constructive ownership rules of § 318(a) as modified by § 304(c)(3).

(i) Before adoption of the liquidation plan, no assets of Sub 1 will have been distributed in kind, transferred, or sold to Distributing, except for (i) transactions occurring in the normal course of business and (ii) transactions occurring more than three years before adoption of the liquidation plan.

(j) Sub 1 holds no assets representing earned but unreported income.

(k) The fair market value of the assets of Sub 1 will exceed its liabilities both at the date of the adoption of the plan of complete liquidation and immediately before the time the first liquidating distribution is made.

(l) Other than intercompany items incurred in the ordinary course of business, there is no intercorporate debt existing between Distributing and Sub 1, and none has

been canceled, forgiven, or discounted.

(m) Distributing is not an organization that is exempt from federal income tax under § 501 or any other provision of the Code.

(n) All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the Liquidation have been fully disclosed.

Recapitalization Representations

The taxpayer has submitted the following representations concerning the Recapitalization:

(o) Controlled and Distributing each will pay its own expenses in connection with the Recapitalization.

(p) The fair market value of the Controlled stock held by each Controlled shareholder immediately following the Recapitalization will approximately equal the fair market value of the Controlled stock held by the shareholder immediately before the Recapitalization.

(q) Controlled is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

(r) There is no plan, intention, or formal or informal understanding to change the capital structure of Controlled to eliminate the two-tiered voting structure of the Class A and Class B shares of Controlled established in the Recapitalization.

Distribution Representations

The taxpayer has submitted the following representations concerning the Distribution:

(s) None of the Class B Shares 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.

(t) The five years of financial information submitted for Business A of Distributing and Business B of Controlled represents, in each case, its present operations and, with regard to each business, there have been no substantial operational changes since the date of the last financial statements submitted.

(u) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.

(v) The Distribution is being undertaken to permit the management of Business A and the management of Business B each to focus more completely on the activities of its own business. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(w) There is no plan or intention by any shareholder who owns five percent or more of the Distributing stock, and the management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular remaining shareholder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the Distribution.

(x) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distribution, other than through (i) purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705, (ii) possibly the purchase by Controlled of some or all of the Controlled Class A shares to be retained by Distributing and Partnership, and (iii) possibly intermittent acquisitions by Controlled of its Class A stock from a pre-existing public shareholder pursuant to a pre-existing contractual relationship (not expected to exceed one percent of the Controlled stock).

(y) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of any of the assets of either corporation after the Distribution, except in the ordinary course of business.

(z) No indebtedness will exist between Distributing and Controlled at the time of, or after, the Distribution.

(aa) Payments made in any continuing transactions between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(bb) The payment of cash in lieu of fractional shares of Controlled stock is solely for the purpose of avoiding the expense and inconvenience to Controlled of issuing and maintaining fractional shares and will not represent separately bargained-for consideration. The method used for handling fractional shares is designed to limit the amount of cash received by any one shareholder to less than the value of one full share of Controlled Class B stock.

(cc) The Distribution is not part of a plan or series of related transactions (within the meaning of § 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 of either Distributing or Controlled entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or

Controlled.

Liquidation Rulings

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

(1) For federal income tax purposes, the merger of Sub 1 into Distributing will be treated as a distribution by Sub 1 of all its assets to Distributing in complete liquidation under § 332 (§ 1.332-2(d) of the Income Tax Regulations).

(2) No gain or loss will be recognized by Distributing on its receipt of the Sub 1 assets in the Liquidation (§ 332(a)).

(3) No gain or loss will be recognized by Sub 1 as a result of the Liquidation (§§ 336(d)(3) and 337(a)).

(4) The basis of each Sub 1 asset in the hands of Distributing will equal the basis of that asset in the hands of Sub 1 immediately before the Liquidation (§ 334(b)(1)).

(5) The holding period of each Sub 1 asset received by Distributing will include the period during which Sub 1 held the asset (§ 1223(2)).

(6) Distributing will succeed to and take into account the items of Sub 1 described in § 381(c), subject to the provisions and limitations of § 381(b) and (c) and the regulations thereunder (§381(a) and § 1.381(a)-1).

(7) Distributing will succeed to and take into account the earnings and profits of Sub 1 as of the date of the merger of Sub 1 into Distributing (§ 381(c)(2)(A) and § 1.381(c)(2)-1). Any deficit in earnings and profits of Distributing or Sub 1 will be used only to offset earnings and profits accumulated after the date of the merger of Sub 1 into Distributing (§ 381(c)(2)(B)).

Recapitalization Rulings

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

(8) The Recapitalization will be treated as an exchange by Distributing of its Old Shares for Controlled Class B Shares and will qualify as a reorganization under § 368(a)(1)(E). Controlled will be a "party to a reorganization" within the meaning of § 368(b).

(9) No gain or loss will be recognized by Distributing as a result of the Recapitalization (§ 354(a)(1)).

(10) The basis of the Controlled Class B shares received in the Recapitalization will equal the basis of the Old Shares surrendered in exchange therefor (§ 358(a)(1)).

(11) The holding period of the Controlled Class B shares received in the Recapitalization will include the period during which the Old Shares surrendered in exchange therefor were held, provided the Old Shares were held as a capital asset on the date of the exchange (§ 1223(1)).

Distribution Rulings

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

(12) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholders as a result of the Distribution (§ 355(a)(1)).

(13) No gain or loss will be recognized by Distributing as a result of the Distribution (§ 355(c)).

(14) The aggregate basis of the Distributing shares and the Controlled Class B shares in the hands of each Distributing shareholder after the Distribution will equal the aggregate basis of the Distributing shares in the hands of the Distributing shareholder immediately before the Distribution (§§ 358(a) and 1.358-1(a)). This basis will be allocated between the Distributing shares and the Controlled Class B shares in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§§ 358(b)(2) and 358(c)).

(15) The holding period of the Controlled Class B shares received by the Distributing shareholders in the Distribution will include the holding period of the Distributing shares on which the Distribution is made, provided that the Distributing shares are held as capital assets on the date of the Distribution (§ 1223(1)).

(16) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(b).

(17) If cash is received by a Distributing shareholder in lieu of a fractional share of Controlled stock, gain or loss will be recognized by the shareholder measured by the difference between the basis of the fractional share interest, as determined in ruling (14) above, and the amount of cash received. If the fractional share qualifies as a capital asset in the hands of the shareholder, the gain or loss will be a capital gain or

loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code (§§ 1221 and 1222).

Miscellaneous Rulings

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

(18) The Prior Distribution will be included in the gross income of each Controlled shareholder to the extent that the Prior Distribution is out of Controlled's accumulated earnings and profits or out of Controlled's current earnings and profits through the close of the year in which the Prior Distribution occurs (§§ 301(c)(1) and 316(a)). If the amount distributed on a Controlled share exceeds the earnings and profits of Controlled attributable to that share, the Prior Distribution will be applied against and reduce the adjusted basis of that share (§ 301(c)(2)). If the amount distributed on a Controlled share exceeds its attributable earnings and profits and its adjusted basis, the excess will be taxable to the holder as capital gain (§ 301(c)(3)).

(19) The proposed transactions will not adversely affect the Prior Ruling Letters, which will remain in full force and effect.

Caveats

We express no opinion on the tax effects of the transactions under any other provisions of the Code or regulations, or the tax effects of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings.

Procedural Statements

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each taxpayer affected by this ruling letter should attach a copy of the letter to its federal income tax return for the taxable year in which the transactions covered by the letter are completed.

Under a power of attorney on file in this office, a copy of this ruling letter will be forwarded to the taxpayer.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By: *Wayne T. Murray*

Wayne T. Murray
Senior Technician/Reviewer
Branch 4