

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Refer Reply To:
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Date:
September 30, 1999

Re:

Parent =

Holding 2 =

Holding 1 =

State X =

Distributing 2 =

Distributing 1 =

Controlled =

Sub 2 =

Main Business =

Business 2 =

Business 3 =

Date 1 =

Dear :

This letter responds to your letter dated March 16, 1999, requesting rulings concerning the federal income tax consequences of certain transactions that have now been consummated. The information submitted for consideration is summarized below.

Parent, a State X corporation, uses the accrual method of accounting and a calendar year. Parent is a mutual holding company which through its various tiers of subsidiaries ("Corporate Group") is primarily engaged in Main Business

Holding 2, a State X corporation, uses the accrual method of accounting and a calendar year. Holding 2 is a member of Corporate Group and is an intermediate holding company whose main asset is the stock of Holding 1. All the stock in Holding 2 is held by Parent.

Holding 1, a State X corporation, uses the accrual method of accounting and a calendar year. Holding 1 is a member of Corporate Group and is an intermediate holding company whose main asset is the stock of Distributing 2. All the stock in Holding 1 is held by Holding 2.

Distributing 2, a State X corporation, uses the accrual method of accounting and a calendar year. Distributing 2 is directly engaged in Main Business and is the largest operating company in Corporate Group. All the stock in Distributing 2 is held by Holding 1.

Distributing 1, a State X corporation, uses the accrual method of accounting and a calendar year. Distributing 1 acts as a holding company for lower tier subsidiaries that are not engaged in Main Business and, in addition, is directly engaged in Business 3 as a result of holding all the stock in Sub 2, a single member LLC, which is so engaged. All the stock in Distributing 1 is held by Distributing 2.

Controlled, a State X corporation, uses the accrual method of accounting and a calendar year. Controlled is directly engaged in Business 2. Prior to the transactions described herein, all the stock in Controlled was held by Distributing 1.

Corporate Group has for many years been engaged in Main Business. Several years ago, like several other companies in its industry, Corporate Group decided to

form a lower tier subsidiary, Controlled, to enter Business 2. Controlled's Business 2, however, has not been as successful as expected and produces only a small part of Corporate Group's income. Corporate Group's management believes that Controlled could significantly improve Business 2 if it could attract more independent sales agents ("ISAs") to sell its products. Most ISAs have been reluctant to sell for Controlled because it was an indirect subsidiary of Distributing 2, which is engaged in Main Business. Main Business is highly regulated, frequently audited, subject to a different regulatory scheme than Business 2, and is perceived by ISAs as having excessively conservative business practices and a "corporate culture" to which ISAs do not relate. Research and focus groups have indicated that ISAs are reluctant to do business with Controlled because it is an indirect subsidiary of Distributing 2 which is engaged in Main Business, but that if Controlled were a subsidiary of Holding 1 the ISAs would be willing to sell for Controlled. Accordingly, in order for Controlled to be a subsidiary of Holding 1, the parties have completed the following steps:

- (I) Distributing 1 distributed all the stock in Controlled to Distributing 2.
- (II) Distributing 2 distributed all the stock in Controlled to Holding 1.

Corporate Group has submitted financial and employee information that indicates that Main Business, Business 2, and Business 3 had gross receipts, operating expenses, and employees indicative of the active conduct of a trade or business for each of the three businesses in each year of the past 5 years.

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

- (a) Steps (I) and (II) above were consummated on Date 1. Date 1 is a date subsequent to the date this ruling request was filed.
- (b) During the past 5 years, except for the transfers of Controlled stock as described in steps (I) and (II) above, and except for transfers in the normal course of business, there have not been any transfers of assets between Holding 1, Distributing 2, Distributing 1, and Controlled, nor is there any plan or intention for there to be any such transfers.
- (c) None of the Controlled stock was received by Distributing 2 or Holding 1 as a creditor or in any capacity other than that of a shareholder.
- (d) The 5 years of financial information submitted on behalf of Distributing 2's Main Business, Distributing 1's Business 3, and Controlled's Business 2 is representative of each of the corporation's present operations, and, with regard to each such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

- (e) Distributing 1 acquired all the stock in Sub 2, and Sub 2 acquired the assets of Business 3, in transactions (“Prior Transactions”) in which no gain or loss was recognized for federal income tax purposes. Prior to its acquisition by Sub 2, Business 3 was operated by another corporate subsidiary of Distributing 1 (“Sub 2 Predecessor”).
- (f) Following the step (I) spin-off of Controlled stock, Distributing 1 has been, and will continue to be, directly engaged in the active conduct of Business 3 as a result of holding all the stock in Sub 2, a single member LLC, which is so engaged. Sub 2 is a disregarded entity for federal income tax purposes and its active business is treated as being the active business of Distributing 1. Immediately prior to the time step (I) was consummated, the fair market value of the gross assets of Business 3 constituted at least five percent of the total fair market value of all the gross assets of Distributing 1. Distributing 1 and, previously, Sub 2 Predecessor have actively conducted Business 3 (within the meaning of § 1.355-3(b)) independently and with their own employees at all times in the 5-year period prior to step (I). For each of the 5 years immediately preceding step (I), Distributing 1’s Business 3 has employed over 30 full-time employees conducting both its operational and managerial activity. Following the step (I) spin-off, Distributing 1’s Business had and will continue to have a minimum of 50 full-time employees conducting both the operational and managerial activities of Business 3.
- (g) Following the step (II) spin-off of Controlled stock, Distributing 2 has been and will continue to be directly engaged in the active conduct of Main Business independently and with its own employees. Main Business was actively conducted (within the meaning of § 1.355-3(b)) by Distributing 2 independently and with its own employees at all times within the 5-year period prior to the distribution of Controlled stock. For each of the 5 years immediately preceding step (II), Distributing 2’s Main Business has employed over 50 full-time employees and, following the step (II) spin-off, Distributing 2 has and will continue to have a minimum of 50 full-time employees conducting both the operational and managerial activities of Main Business.
- (h) Following the step (I) and the step (II) spin-offs, Controlled has been and will continue to be directly engaged in the active conduct of Business 2, independently and with its own employees. Business 2 was actively conducted (within the meaning of § 1.355-3(b)) by Controlled independently and with its own employees throughout the 5-year period immediately preceding the spin-offs. For each of the 5 years immediately preceding steps (I) and (II), Controlled’s Business 2 has employed over 50

full-time employees and, following steps (I) and (II), Controlled has had and will continue to have a minimum of 50 full-time employees conducting both the operational and managerial activities of Business 2.

- (i) The distribution of Controlled stock was carried out for the corporate business purpose of improving sales by attracting ISAs to sell Controlled's products. The distribution of Controlled stock is motivated, in whole or substantial part, by this corporate business purpose.
- (j) Except for the step (II) distribution, Distributing 2 has not sold, exchanged, transferred by gift, had redeemed, or otherwise disposed of any of the stock in either Distributing 1 or Controlled. Nor is there any plan or intention for Distributing 2 to sell, exchange, transfer by gift, have redeemed, or otherwise dispose of any stock in Distributing 1.
- (k) Holding 1 has not sold, exchanged, transferred by gift, had redeemed, or otherwise disposed of any stock in either Distributing 2 or Controlled. Nor is there any plan or intention for Holding 1 to sell, exchange, transfer by gift, have redeemed, or otherwise dispose of any stock in either Distributing 2 or Controlled.
- (l) Neither Distributing 1, Distributing 2, nor Controlled has directly or through any subsidiary corporation purchased any of its outstanding stock. Nor is there any plan or intention by either Distributing 1, Distributing 2, or Controlled to make any such purchase.
- m) There is no plan or intention to liquidate either Distributing 1, Distributing 2, or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation, except for: (i) dispositions in the ordinary course of business; and (ii) transfers described in steps (I) and (II) above.
- (n) No intercorporate debt existed or will exist between either Distributing 1 or Distributing 2 and Controlled at the time steps (I) and (II) were undertaken, or subsequent thereto.
- (o) It is not expected that there will be any transactions between either Distributing 1 or Distributing 2 and Controlled subsequent to the transactions described above. All payments made in connection with any transactions between either Distributing 1 or Distributing 2 and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arms length.
- (p) Neither step (I) nor step (II) constitutes a disqualified distribution within

the meaning of § 355(d).

- (q) The step (I) and step (II) spin-offs are 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 in either Distributing 1, Distributing 2, or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock in either Distributing 1, Distributing 2, or Controlled.

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

- (1) No gain or loss will be recognized to Distributing 1 upon the distribution to Distributing 2, or to Distributing 2 on the distribution to Holding 1, of all the stock in Controlled (§ 355(c)).
- (2) No gain or loss will be recognized to (and no amount will be included in the income of) Distributing 2 or Holding 1 upon receipt of Controlled stock (§ 355(a)(1)).
- (3) Distributing 2's basis in the Controlled stock and the Distributing 1 stock held after the step (I) distribution will be the same as the basis of the Distributing 1 stock held by Distributing 2 immediately before the distribution. The total basis will be allocated in proportion to the relative fair market values of the Controlled stock and Distributing 1 stock in accordance with § 1.358-2(a)(2).
- (4) Holding 1's basis in the Controlled stock and Distributing 2 stock held after the step (II) distribution will be the same as Holding 1's basis in the Distributing 2 stock immediately before the distribution. The total basis will be allocated in proportion to the relative fair market values of the Controlled stock and Distributing 2 stock in accordance with § 1.358-2(a)(2).
- (5) The holding period of the Controlled stock received by Distributing 2 will include the period during which Distributing 2 held the Distributing 1 stock with regard to which the Controlled stock was received, provided that the Distributing 1 stock was a capital asset in the hands of Distributing 2 on Date 1 (§ 1223(1)).
- (6) The holding period of the Controlled stock received by Holding 1 will include the holding period during which Holding 1 held the Distributing 2 stock with regard to which the Controlled stock was received, provided that

the Distributing 2 stock is a capital asset in the hands of Holding 1 on Date 1 (§ 1223(1)).

- (7) As provided in § 312(h), proper allocation of earnings and profits between Distributing 1, Distributing 2, and Controlled will be made under § 1.312-10(b).

No opinion is expressed about the tax treatment of the transactions under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed about the tax treatment of the Prior Transactions (see representation (e) above).

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

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this letter are consummated.

Sincerely yours,
Assistant Chief Counsel (Corporate)

By _____
Mark S. Jennings
Senior Technician Reviewer, Branch 1