

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:B03 PLR-164906-01

Date:

March 22, 2002

Re:

Distributing =

Sub 1 =

Controlled =

LLC =

Trust 1 =

Trust 2 =

Trust 3 =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Individual 1 =

Trustee 1 =

Trustee 2 =

business m =

business n =

Date 1 =

State X =

aa% =

bb =

cc =

dd =

ee =

ff =

gg =

hh =

ii =

jj =

kk =

ll =

mm =

nn =

oo =

pp% =

qq% =

rr =

ss =

tt =

uu =

vv =

ww =

zz% =

Dear

We respond to your letter dated November 19, 2001, for rulings concerning the federal income tax consequences of a proposed transaction. Although your letter requests rulings under the jurisdiction of CC:CORP and CC:PSI, the rulings under the jurisdiction of CC:PSI have been severed from this request and are being answered in a separate letter ruling to be issued by CC:PSI. This letter will address only those rulings within the jurisdiction of CC:CORP. Additional information was submitted in letters dated February 1, March 6, March 11, and March 21, 2002. The material information submitted for consideration is summarized below.

Distributing, a State X corporation, is currently engaged directly in business m. Distributing owns aa% (greater than 90%) of Sub 1, which is engaged in business n. Distributing has two classes of stock, composed of bb shares of Common Stock and cc shares of Class "A" Stock. The shares of Distributing stock are owned as follows: Trust 1 (dd shares of Common Stock and ee shares of Class "A" Stock), Trust 2 (ff shares of Common Stock and gg shares of Class "A" Stock), Trust 3 (hh shares of Common Stock and ii shares of Class "A" Stock), and each of Shareholder 1, Shareholder 2, Shareholder 3, and Shareholder 4 (jj shares of Common Stock and kk shares of Class "A" Stock). The shares in Sub 1 are owned as follows: Distributing (ll), Shareholder 2 (mm), Shareholder 3 (nn), and parties unrelated to any of Distributing's or Sub 1's shareholders (oo), (but under 10% of the total shares in Sub 1).

Distributing uses the cash receipts and disbursements method of accounting for its federal income tax return with a taxable year ending on Date 1. Sub 1 uses the accrual method of accounting for its federal income tax return with a taxable year ending on Date 1. Controlled will use the cash receipts and disbursements method of accounting for its federal income tax return with a taxable year ending on Date 1.

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

In order to enhance the success of business m and business n, and to enable significant shareholder groups to concentrate and focus on the particular business in which they have an interest, the shareholders of Distributing propose to separate such businesses and place them under the directed ownership and control of their respective significant shareholder group. Accordingly, the following transaction is proposed:

- (i) Distributing will form LLC, a limited liability corporation pursuant to State X law. Distributing will contribute land and various assets related to business m to

LLC in exchange for a pp% (greater than 80) interest in LLC. Prior to the split-off transaction (described below), Distributing will take out a bridge loan to finance certain construction related to the business m activities of LLC, using Sub 1 stock as collateral for the bridge loan financing. Distributing will be the manager of LLC under state law, and will perform active and substantial management functions. A party unrelated to Distributing, or any shareholder of Distributing, will own the remaining qq% of LLC. LLC will be treated as a partnership for federal income tax purposes.

(ii) Distributing will form Controlled, a new, wholly owned subsidiary, by contributing all of its assets related to business m, including its interest in LLC, and cash, to Controlled in exchange for all the stock of Controlled and Controlled's assumption of all the liabilities associated with business m plus the liabilities to which such transferred assets are subject (hereinafter referred to as the "Contribution"). Controlled will take the name formerly used by Distributing, and Distributing will surrender such name and assume a new name, yet to be determined, reflecting its business n operation. The reason for the change is that Distributing's former name has always been associated with the business m operations and the parties to the transaction desire to maintain such tradition. The cash contributed will constitute approximately zz% of the fair market value of the assets of Controlled. Controlled will use a portion of the cash it receives in this step (ii), plus permanent financing funds (secured by LLC assets), to pay off the bridge loan in full.

(iii) Distributing will distribute jj shares of Common Stock and kk shares of Class "A" Stock of Controlled to each of Shareholder 1 and Shareholder 2 in exchange for all of Shareholder 1 and Shareholder 2's Common Stock and Class "A" Stock in Distributing. Distributing will distribute rr shares of Common Stock and ss shares of Class "A" Stock of Controlled to Trust 1 in exchange for rr shares of Common Stock and ss shares of Class "A" Stock of Distributing. Distributing will distribute tt shares of Common Stock and uu shares of Class "A" Stock of Controlled to Trust 2 in exchange for tt shares of Common Stock and uu shares of Class "A" Stock of Distributing. Distributing will distribute vv shares of Common Stock and ww shares of Class "A" Stock of Controlled to Trust 3 in exchange for vv shares of Common Stock and ww shares of Class "A" Stock of Distributing (together the "Distribution").

(iv) Shareholder 2 will sell his minority interest of mm shares of Sub 1 to Distributing.

(v) Individual 1 will exercise her testamentary special power of appointment with respect to stock held by Trust 1 and Trust 2, to provide that, upon her death the Distributing stock will be distributed to Shareholder 3, outright, if living, otherwise to his then living issue, per stirpes, and the stock of Controlled is appointed to Shareholder 1, outright, if living, otherwise to her then living issue, per stirpes, all in accordance with the terms of Trust 1 and Trust 2. In the event favorable

rulings are issued in the separate letter ruling from CC:PSI, then the power of appointment is to be exercised so that the Distributing stock is appointed into a trust for the benefit of Shareholder 3 and Shareholder 3's family, and the Controlled stock will be appointed into a trust for the benefit of Shareholder 1, and Shareholder 1's family, all in accordance with the terms of Trust 1 and Trust 2.

(vi) Shareholder 1 and Shareholder 3 will provide to Trustee 2, as trustee to Trust 3, that upon the death of Individual 1, the Distributing stock will be distributed to Shareholder 3, if living, otherwise to Shareholder 3's issue, and the Controlled stock will be distributed to Shareholder 1 if living, otherwise to Shareholder 1's issue.

(vii) In accordance with State X law, Trustee 1 and Trustee 2, as co-trustees of Trust 1 and Trust 2, and Trustee 2, as trustee to Trust 3, shall pursuant to the terms of such trusts give an irrevocable proxy to Shareholder 3 and Shareholder 3's family successors to vote the Distributing shares held by such trusts; and, will give an irrevocable proxy to Shareholder 1 and Shareholder 1's family successors to vote the Controlled shares held by such trusts.

After the proposed transaction Shareholder 3 and Shareholder 4 shall hold shares of Common Stock and Class "A" Stock of Distributing, and Distributing will be indirectly engaged in business n. Shareholder 1 and Shareholder 2 shall hold shares of Common Stock and Class "A" Stock of Controlled, and Controlled will be directly engaged in business m. All Common Stock and Class "A" Stock of Distributing held in Trust 1, Trust 2, and Trust 3 shall be held for the control of Shareholder 3 and Shareholder 3's family successors. All Common Stock and Class "A" Stock of Controlled held in Trust 1, Trust 2, and Trust 3 shall be held for the control of Shareholder 1 and Shareholder 1's family successors.

The taxpayers have made the following representations in connection with the proposed transaction:

- (a) The fair market value of the Controlled stock and other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of Distributing stock surrendered by the shareholder in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of business m and business n is representative of each business' respective present operations, and with regard to each business, there has been no

substantial operational changes since the date of the last financial statements submitted, except for the creation and transfer of certain assets by Distributing to LLC (step (i) above) to engage in business m.

- (d) Immediately after the transaction, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (e) Following the Distribution, Distributing and Controlled each will continue the active conduct of its business, independently and with its separate employees.
- (f) The proposed transaction is carried out for the following corporate business purposes: fit and focus. The Distribution is motivated, in whole or substantial part, by these corporate business purposes.
- (g) Distributing is not an S corporation (within the meaning of § 1361(a)), and there is no plan or intention by Distributing or Controlled to make an S corporation election pursuant to § 1362(a).
- (h) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of their stock in either Distributing or Controlled after the Distribution.
- (i) 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 stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (j) 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 the assets of either corporation after the Distribution, except in the ordinary course of business.
- (k) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (l) 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 neither accumulated its receivables nor made extraordinary

payment of its payables in anticipation of the transaction.

- (n) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the transaction.
- (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 § 1.1502-13 and § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account with respect to Controlled stock will be included in income immediately before the Distribution (See § 1.1502-19).
- (p) Payments made in connection with all continuing transactions, if any, 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.
- (q) Neither Distributing nor Controlled is an investment company as defined in §§ 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 § 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, or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.

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

- (1) The Contribution followed by the Distribution will constitute a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be a "party to a reorganization" within the meaning of § 368(b).
- (2) Distributing will recognize no gain or loss on the Contribution (§§ 361(a), 357(a) and 357(c)).
- (3) Controlled will recognize no gain or loss on the Contribution (§ 1032(a)).
- (4) Controlled's basis in each asset received in the Contribution will equal the basis of that asset in the hands of Distributing immediately prior to the transfer (§ 362(b)).
- (5) Controlled's holding period for each asset received from Distributing will

include the period during which Distributing held such asset (§ 1223(2)).

- (6) Distributing will recognize no gain or loss on the Distribution (§ 361(c)(1)).
- (7) Shareholder 1, Shareholder 2, Trust 1, Trust 2, and Trust 3 will recognize no gain or loss (and no amount will be included in their income) upon receipt of Controlled stock in exchange for their Distributing stock (§ 355(a)(1)).
- (8) The basis of the Controlled stock received by each of Shareholder 1, Shareholder 2, Trust 1, Trust 2, and Trust 3 in the transaction will equal the basis of the Distributing stock surrendered by each of the shareholders, respectively, in exchange therefor (§ 358(a)(1)).
- (9) The holding period of the Controlled stock received by Shareholder 1, Shareholder 2, Trust 1, Trust 2, and Trust 3 in the transaction will include the holding period of the Distributing stock surrendered in exchange therefor, provided the respective shareholder held the Distributing stock as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the proposed transaction under any other provision of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayers 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 a ruling. Verification of the information, representations, and other data may be required as part of the audit process. See section 12.04 of Rev. Proc. 2002-1, 2002-1 I.R.B. 1, 50, which discusses in greater detail the revocation or modification of ruling letters. However, when the criteria in section 12.05 of Rev. Proc. 2002-1, 2002-1 I.R.B. at 50-51, are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

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.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Pursuant to a power of attorney on file in this office, a copy of this letter has been sent to each of your authorized representatives.

Sincerely yours,

Richard E. Coss

Richard E. Coss
Assistant to the Chief, Branch 3
Office of Associate Chief Counsel
(Corporate)