

**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:

**May 15, 2003**

Distributing =

Controlled =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Country A  
Shareholders =

business m =

business n =

business o =  
Country A =  
aa =  
bb =  
cc =  
dd =  
ee =  
ff =  
gg =  
hh =  
ii =  
jj =  
kk =  
ll =

Dear

We respond to your representative's letter dated December 23, 2002, for rulings concerning the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated March 4, April 17, and May 9, 2003. The material information submitted for consideration is summarized below.

Distributing, a corporation formed under the laws of Country A, is a controlled foreign corporation ("CFC") within the meaning of § 957(a) of the Internal Revenue Code, and is currently engaged directly in business m, business n, and business o. Distributing has one class of stock outstanding, which is owned as follows: aa shares by Shareholder 1, bb shares by Shareholder 2, cc shares by Shareholder 3, dd shares by Shareholder 4, ee shares by Shareholder 5, and ff shares by other shareholders who are citizens of Country A (the "Country A Shareholders") (who own less than 10 percent

of the total shares in Distributing). Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4 and Shareholder 5 are all United States persons, as defined in § 951(b). Shareholder 1 and Shareholder 5 serve as President and General Counsel, respectively, of Distributing.

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 take advantage of various Country A tax incentives available under a recently enacted Country A tax law (including the permanent reduction of a certain tax projected to far exceed one percent of the base period net income of Distributing), Distributing proposes the following transaction:

- (i) Distributing will undergo a tax free demerger under Country A law. Distributing will form Controlled under Country A law and transfer assets and liabilities relating to business n and business o to Controlled (hereinafter referred to as the “Contribution”).
- (ii) In addition, as part of the demerger transaction, Distributing will issue new Distributing shares to each of its shareholders in exchange for each shareholder’s preexisting shares in Distributing. The newly issued stock will be issued to the shareholders in the same proportion in which they held the old Distributing stock: Shareholder 1 will exchange aa old shares for gg new shares; Shareholder 2 will exchange bb old shares for hh new shares; Shareholder 3 will exchange cc old shares for ii new shares; Shareholder 4 will exchange dd old shares for jj new shares, Shareholder 5 will exchange ee old shares for kk new shares, and the Country A Shareholders will exchange ff old shares for ll new shares. Both before and after the demerger, Distributing will have only one class of stock outstanding (which will have unlimited rights to participate in the earnings and assets of Distributing), and the Distributing shareholders’ percentage interest in Distributing will not change.
- (iii) Pursuant to Country A law, Controlled will directly issue its shares, pro rata, to Distributing’s shareholders to be owned as follows: gg shares by Shareholder 1, hh shares by Shareholder 2, ii shares by Shareholder 3, jj shares by Shareholder 4, kk shares by Shareholder 5, and ll shares by the Country A Shareholders (hereinafter referred to as the “Distribution”).

Following the Distribution, Distributing and Controlled will each be owned

by Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, Shareholder 5, and the Country A Shareholders. Distributing will be directly engaged in business m and Controlled will be directly engaged in business n.

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

- (a) The indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (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 Distributing's 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.
- (d) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees, and Controlled may employ Shareholder 1 and Shareholder 5 as its President and General Counsel, respectively.
- (e) The proposed transaction is carried out for the following corporate business purposes: reduction of foreign taxes (cost savings). The Distribution is motivated, in whole or substantial part, by this corporate business purposes.
- (f) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the Distribution.
- (g) 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.

- (h) 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.
- (i) The total adjusted bases 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.
- (j) 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.
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.
- (l) 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.
- (m) Neither Distributing nor Controlled is an investment company as defined in §§ 368(a)(2)(F)(iii) and (iv).
- (n) 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.
- (o) Distributing is, and Controlled will be, a corporation within the meaning of § 7701(a)(3), at all times before and immediately after the Contribution and Distribution.
- (p) Distributing is, and Controlled will be, a CFC (within the meaning of § 957(a)) before and after the Contribution and Distribution, but neither corporation is or will be a passive foreign investment company (as defined by § 1297(a)).

- (q) Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, and Shareholder 5 will be § 1248 shareholders with respect to each of Distributing and Controlled, within the meaning of § 1.367(b)-2(b), immediately before and after the Distribution.
- (r) The notice requirements of § 1.367(b)-1(c)(1) will be met for the Contribution and Distribution.
- (s) Following the Distribution, each shareholder of Distributing who is a United States shareholder, as defined in § 951(b), will compute his/her predistribution and postdistribution amount with respect to Distributing and Controlled, as defined under §§ 1.367(b)-5(e)(1) and (2). To the extent the predistribution amount exceeds the postdistribution amount with respect to either Distributing or Controlled, the United States shareholder will make basis adjustments and recognize income (if any), as required under the applicable Treasury regulations.

The taxpayer has made the following additional representation regarding step (ii) of the proposed transaction:

- (t) The exchange by Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, Shareholder 5, and the Country A Shareholders of their Distributing shares for a different number and class of Distributing shares qualifies either as an exchange of common stock for common stock under § 1036 or an exchange of common stock for common stock under § 354 pursuant to a recapitalization of Distributing under § 368(a)(1)(E).

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

- (1) For federal income tax purposes, the proposed transaction will be treated as if Distributing transferred the assets of business n and business o to Controlled in exchange for all of the stock of Controlled and the assumption by Controlled of the liabilities of business n and business o, followed immediately by a distribution of all of the Controlled stock, pro rata, to Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, Shareholder 5, and the Country A Shareholders (*cf.* Rev. Rul. 77-191, 1977-1 C.B. 94). 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, Shareholder 3, Shareholder 4, Shareholder 5, and the Country A Shareholders will recognize no gain or loss (and no amount will be included in their income) upon receipt of the Controlled stock pursuant to the Distribution (§ 355(a)(1)), except to the extent stated in Ruling 12.
- (8) The aggregate basis of the stock of Controlled and Distributing received by each of Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, Shareholder 5, and the Country A Shareholders will equal the basis of the Distributing stock held by each shareholder before the Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2), subject to the adjustments stated in Ruling 12.
- (9) The holding period of the Controlled stock received by Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, Shareholder 5, and the Country A Shareholders will include the holding period of the Distributing stock with respect to which the Distribution is made, provided the respective shareholder held the Distributing stock as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) The Contribution will be an exchange to which §§ 1.367(b)-1(c) and 1.367(b)-4(a) apply.
- (11) Distributing and Controlled will be treated as corporations for purposes of the Contribution and the Distribution.
- (12) The Distribution will be a distribution to which §§ 1.367(b)-1(c), 1.367(b)-5(a), 1.367(b)-5(c), and 1.367(b)-5(f) apply. If Shareholder 1, Shareholder

2, Shareholder 3, Shareholder 4, or, Shareholder 5's postdistribution amounts, as defined in § 1.367(b)-5(e)(2), with respect to Distributing or Controlled is less than Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, or Shareholder 5's predistribution amounts, respectively, as defined in § 1.367(b)-5(e)(1), with respect to Distributing or Controlled, Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, or Shareholder 5's basis in such stock immediately after the Distribution must be reduced by the amount of the difference. However, Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, or Shareholder 5's basis in their stock must not be reduced below zero, and to the extent the foregoing reduction would have reduced basis below zero, Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, or Shareholder 5 must instead include such amount in income as a deemed dividend from such corporation. If Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, or Shareholder 5 reduce their basis in the stock of Distributing or Controlled (or has an inclusion with respect to such stock), Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, or Shareholder 5 shall increase their basis in the stock of the other corporation to the extent provided in § 1.367(b)-5(c)(4).

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. Specifically, no opinion is expressed concerning step (ii), above, of the proposed transaction, the exchange by Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, Shareholder 5, and the Country A Shareholders of their old Distributing shares for a different number and class of shares of Distributing stock.

No opinion is expressed regarding whether Distributing or Controlled is a passive foreign investment company (within the meaning of § 1297(a) and the regulations to be promulgated thereunder), foreign personal holding company (within the meaning of § 552 and the regulations thereunder), or personal holding company (within the meaning of § 542 and the regulations thereunder). If it is determined that Distributing or Controlled is a passive foreign investment companies, no opinion is expressed with respect to the application of §§ 1291 through 1298 to the proposed transaction. In particular, in a transaction in which gain is not otherwise recognized, regulations under § 1291(f) may require gain recognition notwithstanding any other provision of the Code.



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 sections 12.04 and 12.05 of Rev. Proc. 2003-1, 2003-1 I.R.B. 1, 44, which discuss in greater detail the revocation or modification of ruling letters. However, when the criteria in section 12.06 of Rev. Proc. 2003-1, 2003-1 I.R.B. at 45, 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 your authorized representative.

Sincerely,

Richard E. Coss

Richard E. Coss  
Senior Counsel, Branch 3  
Office of Associate Chief Counsel  
(Corporate)

cc: