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Person to Contact:

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P =

US =

I =

U =

W =

X =

Newco =

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Country X =
State Y =
State Z =
Date1 =
Date2 =
Date3 =
m =

a =
b =
c =

This letter replies to a request for rulings, dated September 9, 1998, on the federal income tax consequences of a proposed transaction concerning § 368(a)(1)(D) of the Internal Revenue Code. We received additional information in letters dated December 10, 1998, January 5, January 19, January 25, and February 16, 1999. The information submitted for consideration is summarized below.

P is a Country X corporation which holds all of the stock of US, a State Y corporation. US is the common parent of affiliated group of corporations which is engaged in business m. US owns all of the stock of the following corporations: T, U, V, and W which are included in its affiliated group. In addition, US, V, T, and W, are United States Real Property Holding Corporations ("USRPHCs") as defined in § 897(c)(2). T has a wholly owned subsidiary, X which is a foreign sales company as defined in § 922. US's dividends to P have included \$a on Date1, \$b on Date2 and \$c on Date3.

For a valid business purpose the following transaction has been proposed:

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- (i) U will borrow an amount approximately equal to its net worth and distribute that amount to its parent, US, with respect to its stock. The borrowing will only be secured by the assets of U. US will contribute the funds to T as a contribution to the capital of T.
- (ii) US will form a newly created State Z corporation, Newco, and in exchange for all of the common stock of Newco, transfer to Newco: (a) substantially all of US's directly owned assets and associated liabilities, and (b) all of US's stock in T and W.
- (iii) US will liquidate and distribute all of its remaining assets to P. The assets that US will distribute to P are US's stock in Newco, U, and V. US will dissolve under applicable state law.

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) The fair market value of the Newco stock and other consideration received by P will be approximately equal to the fair market value of the Newco stock surrendered in the exchange.
- (b) P has no plan or intention to sell, exchange, or otherwise dispose of a number of shares of Newco stock received in the exchange that would reduce P's ownership of Newco shares to a number of shares having a value, as of the date of the transaction, of less of less than 50 percent of the total value of all of the formerly outstanding stock of US as of the same date.
- (c) Newco will acquire at least 90 percent of fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by US immediately prior to the transaction. For purposes of this representation, amounts used by US to pay its reorganization expenses, all redemptions, and the distribution made by US of \$c on Date3 will be included as assets of US held immediately prior to the transaction.
- (d) After the transaction P will be in control of Newco U, V, and W within the meaning of section 368(a)(2)(H) of the Internal Revenue Code.
- (e) Newco has no plan or intention to redeem or reacquire any of its stock issued in the transaction.
- (f) Newco has no plan or intention to dispose of any of the transferred property other than in the normal course of its business operations.

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- (g) The fair market value and the adjusted basis of the assets of US transferred to Newco each will equal or exceed the sum of the liabilities to be assumed by Newco, plus the amount of any liabilities to which the transferred assets are subject.
- (h) The liabilities of US assumed by Newco plus the liabilities, if any, to which the transferred assets are subject were incurred by US in the ordinary course of its business and are associated with the assets transferred.
- (i) Following the transaction, Newco will continue the historic business of US or use a significant portion of US's historic business assets in a business.
- (j) At the time of the transaction, Newco, T, U, V, or W, will not have outstanding any warrants, options, convertible securities, or any other type or right pursuant to which any person could acquire stock in Newco, T, U, V, or W, that, if exercised or converted, would affect the P's retention of control of Newco, T, U, V, or W, as defined in § 368(a)(2)(H).
- (k) P will pay or assume only those expenses of US that are solely and directly related to the transaction in accordance with the guidelines established in Rev. Rul. 73-54, 1973-1 C.B. 187. Except for these valid reorganization expenses of US assumed by P, P and US will each pay their respective expenses, if any, incurred in connection with the transaction.
- (l) There is no intercorporate indebtedness existing between Newco, S, T, U, V, or W that was issued, acquired, or will be settled at a discount.
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) US is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).
- (o) At the time of the proposed transaction, US, T, and Newco will each be a USRPHC as defined in § 897(c)(2) and the related regulations.

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

- (1) The transfer by US to Newco of assets including the stock of T and W solely in exchange for all of the stock of Newco and the assumption of certain liabilities, as described above, followed by the distribution of the remaining assets of US to P in complete liquidation and dissolution of US will be a reorganization within the

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meaning of § 368(a)(1)(D). For purposes of this ruling, "substantially all" means at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets of US. US and Newco will each be "a party to a reorganization" within the meaning of § 368(b).

- (2) US will recognize no gain or loss upon the transfer of assets, subject to liabilities, to Newco in exchange for Newco stock and Newco's assumption of liabilities (§§ 357(a) and 361(a)).
- (3) Newco will recognize no gain or loss on the receipt of US assets in exchange for Newco stock (§ 1032(a)).
- (4) US will recognize no gain or loss on the distribution of the Newco stock to P pursuant to the plan of reorganization (361(c)(1)). US will recognize gain, if any, but not loss, on the distribution of the stock of U and V to P (§ 361(c)(2)).
- (5) Newco's holding period for the US assets will include the period during which US held those assets. (§ 1223(2)).
- (6) Newco's basis in the US assets received in the transaction will, in each instance, equal the basis of those assets in the hands of US immediately before the transfer (§ 362(b)).
- (7) P will recognize gain, if any, in an amount not in excess of the fair market value of the stock of U and V on the date of the distribution (§ 356(a)(1)). Such amount shall be treated under § 356(a)(2) as a dividend to P to the extent of the undistributed earnings and profits of US, with any excess treated as gain from the exchange of property in accordance with the principles set forth in *Commissioner v. Clark*, 487 US 726 (1989). No loss will be recognized by P (§ 356(c)). Any amount treated as a dividend under § 356(a)(2) will be taxable to P under § 881(a), and any excess treated as a gain under § 356(a)(2) will be taxable to P under §§ 882(a) and 897.
- (8) P's basis in the Newco stock received in the exchange will be equal to the basis of the US stock surrendered in exchange therefor decreased by the fair market value of the U and V stock received and increased by the amount of the fair market value of the stock of U and V treated as a dividend and the amount of gain recognized by P on the exchange (not including any portion of the gain which was treated as a dividend) (§ 358(a)(1)). The basis of the stock of U and V will be the fair market value of the stock (§ 358(a)(2)).
- (9) P's holding period in the Newco stock received in the reorganization will include the period that P held the US stock surrendered exchange therefor, provided

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that the US stock is held as a capital asset on the date of the exchange. P's holding period in the U and V stock will begin on the date P receives the stock (§ 1223(1)).

- (10) Pursuant to § 1.381(b)-1(b), Newco will succeed to and take into account, as of the close of the date of transfer, the items of US described in § 381(c) (§§ 381(a) and 1.381(a)-1). Newco will take these items into account subject to the conditions and limitations specified in §§ 381, 382, 383 and 384, and the regulations thereunder.
- (11) Following the transaction, Newco, T, and W will constitute an affiliated group under § 1504. Newco will become the new common parent of the group and file a consolidated federal income tax return that includes T and W. The taxable year of T and W will not close as a result of the transaction (§ 1502-75(d)(2)).
- (12) The period of use of the net operating loss carryforward of Newco pursuant to § 172(b)(1) will not be affected by the proposed transaction (§ 1.1502-21T(b)(3)(iii)).
- (13) Newco will capitalize or deduct, as appropriate, the amounts it pays, if any, to satisfy the contingent liabilities of US. (Rev. Rul. 95-74 1995-2 C.B. 36).
- (14) Provided that the requirements of § 1.897-5T(d)(1)(iii) as modified by Notice 89-57 are met, P will recognize no gain or loss under § 897(e) upon its receipt of the Newco stock in exchange for its US stock in an exchange that qualifies under § 354. (§ 1.897-6T(a)(1)).

In regard to the withholding responsibilities of the parties under § 1445 on the exchange of the US stock under § 897(e) and any gain under § 356(a)(2), see § 1445 and the regulations under that section. In regard to the withholding responsibilities on the receipt of any dividend under § 356, see § 1442 and the regulations under that section. See also the income tax treaty between the United States and Country X in regard to any benefits on the receipt of the dividend.

We express no opinion about the tax treatment of the proposed transaction 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 proposed transaction that are not specifically covered by the above rulings.

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

Each affected taxpayer must attach a copy of this letter to the taxpayer's federal

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income tax returns for the tax year in which the transaction covered by this ruling letter is consummated.

We are sending a copy of this letter to the authorized representative specified in the power of attorney on file in this office.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Victor L. Penico

Victor L. Penico
Branch Chief, Branch 3