

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

Date:
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Transferor / Parent =

Transferee / Sub =

Corp A =

Corp B =

Date A =

State X =

County A =

Business A =

Division A =

Division B =

Division C =

Division D =

The Act =

a =

b =

c =

d =

This letter is in response to your request, dated August 7, 1998, for rulings relating to the federal income tax consequences of a proposed transaction. The information submitted for consideration is summarized below.

The Transferor is a corporation duly incorporated on Date A in State X. The Transferee is a new State X corporation formed to facilitate the proposed transaction. Both the Transferor and the Transferee will be on the accrual method of accounting for income tax purposes.

The Transferor has four separate operating divisions consisting of Division A, Division B, Division C, and Division D. Each division provides specific services to rural local consumers located in County A, State X.

Division A is a state regulated operation. Division B, Division C, and Division D are nonregulated operations. State X prohibits the use of regulated operations to "cross subsidize" nonregulated operations. Accordingly, transactions between regulated and nonregulated business segments must be conducted and accounted for separately and at "arms length." The Transferor believes that accounting for both its regulated and nonregulated operations under the same corporate entity make it more susceptible to allegations of "cross subsidizing" from regulators and competitors.

The Transferor believes the proposed separation of the regulated and unregulated divisions will facilitate the regulatory process and provide further assurances to regulators and competitors that the regulated operations are not being used to subsidize nonregulated operations. Further, the Transferor believes the proposed transaction will enable the Transferor to more adequately respond to the new competitive environment promoted and encouraged under The Act.

For the reasons expressed above, Division A will separate from the Transferor through the following series of transactions:

- Step 1: The Transferor will form the Transferee as a State X corporation with one class of common voting stock.
- Step 2: The Transferor will transfer assets of Division A to the Transferee in exchange for Transferee common stock and the assumption of

the Transferor's Division A liabilities.

- Step 3: The Transferor will continue to operate its other divisions immediately after the exchange.
- Step 4: Immediately after the exchange, the Transferee will change its corporate name to Corp A and the Transferor will change its name to Corp B.

In the transaction, none of the assets to be transferred were received by the Transferor as part of a plan of liquidation of another. No patents or patent applications, copyrights, franchises, trademarks or trade names are being transferred. No licenses, leases, etc. will be granted in exchange for stock or securities. No property transferred to the Transferee will be leased back to the Transferor, other shareholder, or a related party. The transaction does not involve an agreement that purports to furnish technical "know how" in exchange for stock. And, stock of another corporation is not part or all of the property being transferred to the Transferee.

The Transferor will transfer the following assets of Division A: cash and cash equivalents, temporary investments, accounts receivable, inventory, prepaid assets, and property and equipment. In return, no other property in addition to common stock will be issued to the Transferor. Here, the stock which will be issued by the Transferee will consist of voting common stock with a \$a par value, b shares authorized with c shares to be issued to the Transferor. Common stock will not be issued by the Transferee to the Transferor for services.

The Transferee will be formed immediately prior to the exchange and will authorize b shares of voting common stock and issue c shares of voting common stock with a \$a par value. The Transferor will not hold any shares in the Transferee prior to the exchange. The total number of shares of each class will be c shares of voting common stock with a par value of \$a per share. The Transferor will hold d% of the voting common stock or c shares.

None of the stock which will be issued by the Transferee will be placed in escrow, or will be issued later under a contingent stock arrangement. No stock will be issued in the near future in addition to that being issued under the plan. No public offering is being planned. No rights, warrants, or subscriptions of the Transferee are outstanding or will be issued or offered. The Transferor will not dispose of any shares of stock received in the exchange.

There are no applicable related, connected, or step transactions. There is no intention to form a bank holding company. And, the Transferee does not intend to make the election under section 1362(a) of the Code to be taxed as a "small business corporation" as defined in section 1361(a).

The following representations have been made with respect to the Transferor's contribution of its Division A to the Transferee.

- a. No stock or securities will be issued for services rendered to or for the benefit of the Transferee in connection with the proposed transaction, and no stock or securities will be issued for indebtedness of the Transferee that is not evidenced by a security or for interest on indebtedness of the Transferee which accrued on or after the beginning of the holding period of the Transferor for the debt.
- b. The transfer is not the result of the solicitation by a promoter or broker or investment house.
- c. The Transferor will not retain any rights in the property transferred to the Transferee.
- d. The value of the stock received in exchange for accounts receivable will be equal to the net value of the accounts transferred, i.e. the face amount of the accounts receivable previously included in income less the amount reserved for bad debts.
- e. The adjusted basis and the fair market value of the assets to be transferred by the Transferor to the Transferee will, in each instance, be equal to or exceed the sum of the liabilities to be assumed by the Transferee plus any liabilities to which the transferred assets are subject.
- f. The liabilities of the Transferor to be assumed by the Transferee were incurred in the ordinary course of business and are associated with the assets to be transferred.
- g. There is no indebtedness between the Transferee and the Transferor and there will be no indebtedness created in favor of the Transferor as a result of the transaction.
- h. The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.
- i. All exchanges will occur on approximately the same date.
- j. There is no plan or intention on the part of the Transferee to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.
- k. Taking into account any issuance of additional shares of Transferee's

stock; any issuance of stock for services; the exercise of any Transferee's stock rights, warrants, or subscriptions; a public offering of Transferee's stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of the Transferee to be received in the exchange, the Transferor will be in control of the Transferee within the meaning of section 368(c) of the Code.

- I. The Transferor will receive stock, securities or other property approximately equal to the fair market value of the property transferred to the Transferee or for services rendered or to be rendered for the benefit of the Transferee.
- m. The Transferee will remain in existence and retain and use the property transferred to it in a trade or business.
- n. There is no plan or intention by the Transferee to dispose of the transferred property other than in the normal course of business operations.
- o. Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the proposed transaction.
- p. The Transferee will not be an investment company within the meaning of section 351(e)(1) of the Code and section 1.351-1(c)(1)(ii) of the regulations.
- q. The Transferor is not under the jurisdiction of a court in a Title 11 or similar case (within the meaning of section 368(a)(3)(A)) and the stock or securities received in the exchange will not be used to satisfy the indebtedness of such debtor.
- r. The Transferee will not be a personal service corporation within the meaning of Section 269A of the Code.

Based on the facts and information submitted and the representations set forth above, it is held as follows:

(1) The Transferor will recognize no gain or loss on its transfer of assets to the Transferee solely in exchange for Transferee stock and the assumption by the Transferee of liabilities (§§ 351(a) and 357(a)).

(2) The Transferor's basis in the Transferee stock received in the exchange will equal the basis of the assets transferred to the Transferee, reduced by the sum of liabilities

assumed by the Transferee plus the liabilities to which the assets are subject (§§ 358(a) and (d)).

(3) The Transferor's holding period in the Transferee stock received will include the period during which the Transferor held the assets exchanged, provided they were capital assets or property described in section 1231 at the time of the transaction (§ 1223(1)).

(4) The Transferee will recognize no gain or loss on the receipt of the Transferor's assets in exchange for Transferee stock (§ 1032(a)).

(5) The Transferee's basis in each asset received in the exchange will equal the basis of such asset in the hands of the Transferor immediately before the transfer (§ 362(a)).

(6) The Transferee's holding period for each asset received from the Transferor will include the holding period of the asset in the hands of the Transferor immediately before the transfer (§ 1223(2)).

The rulings contained in this letter are predicated upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by the appropriate party. This office has not verified any of the material submitted in support of the ruling request. Verification of the factual information and other data may be required as part of the audit process.

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

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

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

Sincerely yours,

Assistant Chief Counsel (Corporate)

By *Victor Penico*
Victor Penico
Chief, Branch 3