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Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
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Taxpayer =

US1 =

US2 =

F1 =

F2 =

F3 =

F4 =

F5 =

F6 =

F7 =

F8 =

State A =

State B =

Country C =

Country D =

Country E =

Country F =

Country G =

Product aa =

Business bb =

Business cc =

Date H =

Date I =

Date J =

Date K =

Date L =

Dear

This responds to your letter dated October 20, 1998, requesting a ruling as to the federal income tax consequences of transactions under section 367 of the Internal Revenue Code and Temporary Treasury Regulation (Treas. Reg.) §1.367(a)-3T. The information submitted for consideration is summarized below.

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

Taxpayer is a domestic corporation organized under the laws of State A. Taxpayer and its affiliates (domestic and foreign) are engaged in the development, manufacture, sale, and service of Product aa.

Taxpayer owns all the stock of US1 and US2, domestic corporations organized under the laws of State B. US1 and US2 are included in Taxpayer's consolidated federal tax return. US1 owns all the stock of F1, a corporation organized under the laws of Country C, and all the stock of F2, a corporation organized under the laws of Country D. F2 owns all of the stock of F3, a corporation organized under the laws of Country D. F3 owns all of the stock of F4, another corporation organized under the laws of Country D.

Taxpayer owned all the stock of F5, a Country E corporation. On Date H, Taxpayer transferred all (except for a nominal interest) of F5's common stock to US1. On Date J, Taxpayer also transferred all of F5's preferred stock to US1. On Date I, US1 transferred the F5 common stock to F6, a Country E corporation wholly owned by US1, and entered into a 10-year gain recognition agreement with respect to that transfer under Notice 87-85 and Treas. Reg. §1.367(a)-3T(g).

On Date J, US1 transferred all of F5's preferred stock to F7, a Country F corporation wholly owned by US1. F7 then immediately transferred the F5 stock to F8, a Country G corporation owned entirely by F7 except for a nominal interest held by US1. US1 entered into a 10-year gain recognition agreement with respect to its transfer of F5 preferred stock to F7, pursuant to Notice 87-85 and Treas. Reg. §1.367(a)-3T(g). Under the gain recognition agreement, US1 warranted, with respect to F7's transfer of F5 preferred stock to F8, that US1 will be informed of any disposition of F5 stock by F8 and will recognize the appropriate amount of gain realized on the initial transfer of F5 stock to F7.

F5 had five business divisions and sold two divisions (Business bb and Business cc) to other affiliates within Taxpayer's affiliated group. F5 sold all of the assets of Business bb to F4, effective on Date K, for cash and notes. F5 also sold all of the assets of Business cc to US2 and F1, effective on Date L, for cash and notes.

US1's transfer of F5 common to F6 and F5 preferred stock to F7 occurred prior to July 20, 1998 (the effective date of final regulations governing the transfer of foreign

stock under section 367(a)). Thus, such transfers of foreign stock are subject to the rules of Treas. Reg. §1.367(a)-3T and Notice 87-85 (see Treas. Reg. §1.367(a)-3(g)).

Under the final regulations of Treas. Reg. §1.367(a)-3(e), there is an election to apply provisions of the final regulations to transfers occurring before July 20, 1998 if certain conditions are met. The effect of the election would be to reduce the term of 10-year gain recognition agreements (entered into before the July 20, 1998 effective date) to a term of 5-years, which in this case would cause US1's gain recognition agreements with respect to F5 stock to expire (see Treas. Reg. §1.367(a)-3(e)(2). The terms of the election also provide that the provisions of §1.367(a)-3T(g) will apply, and, for this purpose, the term "substantial portion" under §1.367(a)-3T(g)(3)(iii) will be interpreted to mean "substantially all" as defined in section 368(a)(1)(C). The election applies, however, only to the extent that a gain recognition agreement has not been triggered prior to July 20, 1998. In this case, F5's sale of Business bb and Business cc assets occurred before July 20, 1998 and constituted potential triggering events under US1's gain recognition agreements with respect to F5 stock.

If a gain recognition agreement under the temporary regulations is currently in effect with respect to the transfer of foreign stock, Treas. Reg. §1.367(a)-3T(g)(3)(iii) provides that a disposition by the transferred corporation (F5) of all or a substantial portion of its assets outside the ordinary course of business will cause the U.S. transferor (US1) to recognize a proportionate amount of gain realized but not recognized on the initial transfer.

Taxpayer is considering making an election under Treas. Reg. §1.367(a)-3(e) and requests a ruling that F5's disposition of Business bb and Business cc assets did not trigger the recognition of gain under the gain recognition agreements entered into with respect to F5 stock. Based solely on the information submitted and on the representations set forth herein, it is held as follows:

> No gain will be recognized under the Date I and Date J gain recognition agreements entered with respect to the transfers of F5 stock to F6 and F7, if the Business bb and Business cc assets disposed by F5 do not constitute a substantial portion of the assets of F5 under Treas. Reg. §1.367(a)-3T(g)(3)(iii). A disposition of a substantial portion of F5's assets for these purposes means a disposition by F5 of substantially all (within the meaning of section 368(a)(1)(C)) of its assets.

No opinion is expressed about the tax treatment of the proposed transactions under any other provisions of the Code or the 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 ruling.

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

A copy of this letter and the substitute gain recognition agreement, as described above, should be attached to the federal income tax return of the taxpayers involved for the taxable years in which any of the transactions that are the subject of this ruling are consummated.

Sincerely,

Charles P. Besecky

Charles P. Besecky
Chief, Branch 4
Office of Associate Chief
Counsel (International)

cc: