

Internal Revenue Service

Department of the Treasury

Number: **200345050**
Release Date: 11/07/2003
Index Number: 355.01-00, 368.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:1-PLR-122488-02
Date:
September 30, 2002

In re:

Legend:

Distributing =

Subsidiary1 =

Controlled =

State A =

State B =

Business X =

Business Y =

PLR-122488-02

Date 1 =
Date 2 =
Date 3 =
Date 4 =
A =
\$B =
\$C =
D% =
Investment Banks =

Dear

This letter is in response to your letter dated April 18, 2002, requesting rulings on certain Federal income tax consequences of a proposed and partially consummated transaction. Additional information was received in subsequent letters dated June 19, 2002 and August 1, 2002. The material information submitted for consideration is summarized below.

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

SUMMARY OF FACTS

Distributing, a publicly traded State A corporation, is the common parent of a consolidated group. Approximately A shares of Distributing common stock are outstanding. Based on the absence of filings of Schedules 13D and 13G with respect to Distributing's stock, no person holds five percent or more of Distributing's common stock. Distributing has no other class of stock outstanding. As of Date 1, Distributing and its consolidated subsidiaries had outstanding debt in excess of \$B. Distributing will not increase its debt in contemplation of the transactions that are the subject of this ruling, other than in the ordinary course of its business as necessary to meet its working capital and similar needs.

PLR-122488-02

Prior to Date 2, Distributing wholly owned Subsidiary1, a State B limited liability company. Subsidiary1 was a disregarded entity for federal income tax purposes. As part of the proposed transaction, on Date 2, Subsidiary1 converted to a corporation under State B law and changed its name to Controlled.

Distributing is engaged in Business X. Subsidiary1 was engaged in Business Y, and Controlled is engaged in Business Y. Distributing uses the accrual method of accounting for its federal income tax return and has a taxable year ending on Date 3 for federal income tax purposes.

We have received financial information indicating that Business X and Business Y 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.

Distributing has provided substantiation that separating Businesses X and Y will benefit both Business X and Business Y because it will alleviate certain management, systemic and other problems attributable to the affiliation of the businesses, allow the respective managements of the businesses to focus on their core businesses, prevent loss of current and future customers of the businesses attributable to the affiliation of the businesses, and enable the respective companies to offer equity incentives that are closely linked to the operations of the businesses. Accordingly, the following steps have been proposed, and partially consummated, by the taxpayers:

(i) Pursuant to State B law, Subsidiary1 converted to a State B corporation and changed its name to Controlled on Date 2. Pursuant to the conversion, Distributing exchanged its interests in Subsidiary1 for all of the shares of Controlled common stock (the "Contribution").

(ii) In connection with the Contribution and the Distribution (described in step (vi) below), Controlled will declare a dividend to Distributing in the amount of up to \$C.

(iii) Controlled expects to borrow up to \$C through a combination of a note offering and credit facilities (the "Borrowing").

(iv) Shortly after the Borrowing, Controlled will distribute the net proceeds of the Borrowing up to \$C to Distributing to pay the dividend declared in Step (ii) (the "Borrowing Proceeds Distribution"). Within three months of the Borrowing Proceeds Distribution, Distributing will use the cash proceeds to pay its creditors.

(v) At one or more times prior to Step (vi) and in connection with the reorganization, Distributing will transfer shares of Controlled common stock (representing up to D% of the outstanding Controlled common stock) to Investment Banks in exchange for outstanding Distributing debt held by Investment Banks (the "Exchange"). Distributing will not issue new debt in anticipation of the Exchange. The Distributing debt held by Investment Banks will have been acquired on the secondary market at least fourteen days prior to the Exchange. Investment Banks subsequently will attempt to resell the shares to the public in an initial public offering (the "IPO"). Investment Banks will be acting for their own accounts in acquiring Distributing debt

PLR-122488-02

before the Exchange, exchanging Distributing debt for shares of Controlled common stock, and attempting to sell their Controlled common stock to the public in the IPO.

(vi) Within twelve months from the date of this ruling, Distributing will distribute pro rata to its shareholders all the Controlled common stock that it then holds (the "Distribution").

(vii) Distributing will not issue fractional shares in the Distribution. Instead, a distribution agent will aggregate and sell on the open market all fractional shares and distribute the proceeds to those shareholders otherwise entitled to fractional shares.

In conjunction with the proposed transactions, Distributing and Controlled will enter into several agreements relating to their separation and certain continuing transactions between the companies (the "Agreements"), including a transition services agreement and a tax sharing agreement.

REPRESENTATIONS

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

- (a) Neither Distributing nor Controlled was a United States real property holding corporation (as defined in § 897(c)(2)) at any time during the five-year period ending on the date of the Distribution, and neither Distributing nor Controlled will be a United States real property holding corporation immediately after the Distribution.
- (b) The indebtedness, if any, owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (c) No part of the outstanding capital stock of Controlled 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.
- (d) Immediately after the Distribution, the gross assets of Distributing comprising Business X will have a fair market value that is equal to or greater than five percent of the total fair market value of the gross assets of Distributing.
- (e) The five years of financial information submitted on behalf of Business X is representative of the business' present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) Immediately after the Distribution, the gross assets of Controlled comprising Business Y will have a fair market value that is equal to or greater than five percent of the total fair market value of the gross assets of Controlled.

PLR-122488-02

- (g) The five years of financial information submitted on behalf of Business Y is representative of the business' present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (h) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (i) The Distribution of the stock of Controlled is carried out for the following corporate business purposes: to alleviate certain management, systemic and other problems attributable to the affiliation of the businesses, to allow the respective managements of the businesses to focus on their core businesses, to prevent loss of current and future customers of the businesses attributable to the affiliation of the businesses, and to enable the companies to offer equity incentives that are closely linked to the operations of the businesses. The Distribution of the Controlled common stock is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (j) There is no plan or intention by any shareholder who owns five percent or more of the stock of Distributing, and the management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular remaining shareholder or security holder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the transaction.
- (k) 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 transaction, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (l) 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.
- (m) 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 fifty percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing fifty percent or more of the total value of all classes of stock of either Distributing or Controlled.
- (n) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing pursuant to the Contribution each will be equal to or exceed the sum of the liabilities to be assumed by

PLR-122488-02

Controlled, if any, plus any liabilities to which the transferred assets are subject.

- (o) The liabilities to be assumed in the Contribution, if any, and any liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets to be transferred.
- (p) The income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to § 50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
- (q) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transactions described in Steps (i) thru (vii).
- (r) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, other than trade receivables/payables having arm's length terms and incurred in the ordinary course of Distributing's and Controlled's respective businesses pursuant to the Agreements.
- (s) 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 Treas. Reg. § 1.1502-13 and Treas. Reg. § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect, Treas. Reg. § 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account, if any, with respect to the Controlled common stock will be included in income immediately before the Distribution. (See Treas. Reg. § 1.1502-19).
- (t) 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.
- (u) Neither Distributing nor Controlled is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).
- (v) The payment of cash in lieu of fractional shares of Controlled common stock will be undertaken solely for the purpose of saving the expense and inconvenience of issuing and transferring fractional shares and does not represent separately bargained-for consideration.
- (w) The Distribution will occur no later than the earlier of (i) six months after the IPO, or (ii) twelve months after receipt of this ruling.

RULINGS

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

- (1) The transfer of assets pursuant to the Contribution by Distributing to Controlled in exchange for the Controlled common stock, the assumption by Controlled of related liabilities, and cash from the Borrowing Proceeds Distribution, followed by the Distribution, constitutes a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be a “party to the reorganization” within the meaning of § 368(b).
- (2) Distributing will recognize no gain or loss on the transfer of assets pursuant to the Contribution to Controlled, subject to liabilities, in exchange for Controlled common stock, the assumption by Controlled of related liabilities, and the receipt of cash from the Borrowing Proceeds Distribution which will be used to pay Distributing’s creditors. (Sections 357(a), 361(a), and 361(b)(3)).
- (3) No gain or loss will be recognized by Controlled on the receipt of assets pursuant to the Contribution. (Section 1032(a)).
- (4) The basis of each asset received by Controlled pursuant to the Contribution will be equal to the basis of such asset in the hands of Distributing immediately before the Contribution. (Section 362(b)).
- (5) The holding period for each asset received by Controlled pursuant to the Contribution will include the holding period of such asset in the hands of Distributing. (Section 1223(2)).
- (6) The Controlled common stock received by Distributing will constitute “qualified property” within the meaning of § 361(c)(2)(B). The transfer by Distributing to its creditors, Investment Banks, of up to D% of the Controlled common stock constituting qualified property will not result in the recognition of gain or loss to Distributing. (Section 361(c)(1) and (3)).
- (7) No gain or loss will be recognized by Distributing upon the Distribution of the Controlled common stock to the shareholders of Distributing. (Section 361(c)(1)).
- (8) No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing upon the receipt of the Controlled common stock distributed to them in the Distribution. (Section 355(a)(1)).
- (9) The aggregate basis of the Distributing common stock and the Controlled common stock in the hands of each shareholder of Distributing after the

PLR-122488-02

Distribution will equal the basis of the Distributing stock held by such shareholder immediately prior to the Distribution, allocated in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a)(2). (Section 358(a), (b), and (c)).

- (10) The holding period of the Controlled common stock that each Distributing shareholder receives will include the holding period of the Distributing common stock with respect to which the Distribution will be made, provided the Distributing common stock is held as a capital asset by such shareholder on the date of the Distribution. (Section 1223(1)).
- (11) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with Treas. Reg. §§ 1.312-10(a) and 1.1502-33.
- (12) Where cash is received by a Distributing shareholder in lieu of fractional share interests of Controlled common stock, Distributing will be treated as distributing the fractional share to the shareholder and such fractional share will be treated as having been disposed of by such shareholder for the amount of such cash in a sale or exchange. The gain (or loss), if any, will be treated as a capital gain (or loss), provided such stock was held as a capital asset by the selling Distributing shareholder. (Section 1001).

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.

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 is being sent to the taxpayer.

Sincerely,

Lisa A. Fuller
Assistant Branch Chief, Branch 1
Office of Associate Chief Counsel
(Corporate)

cc: