

Internal Revenue Service

Department of the Treasury

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Date:

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Distributing =

Sub 1 =

Sub 2 =

Controlled =

Shareholder 1 =

business m =

business n =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

aa% =

yy% =

zz% =

We respond to your representative's letter dated September 18, 2001, for rulings concerning the federal income tax consequences of a proposed and partially consummated transaction. Additional information was submitted in letters dated January 8, 11, 16, 24, February 14 and 20, 2002. The material information submitted for consideration is summarized below.

Distributing, a publicly traded domestic corporation, is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Prior to Date 1, Distributing owned all of common stock and Series A preferred stock of Controlled, which together comprise aa% (greater than 80%) of the total voting power of all classes of Controlled stock entitled to vote. Controlled owns shares in other foreign subsidiaries, which are otherwise not relevant for the transaction proposed herein. Distributing and Controlled both use the accrual method of accounting for its federal income tax return, and have a taxable year ending on Date 2. Distributing is directly engaged in business m. Controlled is directly engaged in business n. Controlled was incorporated by Distributing on Date 3. On Date 4, Distributing contributed all its assets relating to business n to Controlled in a transaction represented to qualify under § 351.

Shareholder 1 is currently a member of the Boards of Directors of Distributing and Controlled. Before the proposed and partially consummated transaction Shareholder 1 owned directly or beneficially yy% (greater than 5%) of Distributing common stock, and after the proposed transaction is expected to own directly or beneficially zz% (greater than 5%) of Controlled common stock. The taxpayer represents that Shareholder 1 will resign from the Board of Directors of either Distributing or Controlled within 6 months after the proposed transaction takes place.

Distributing and Controlled will enter into several transitional agreements ("Transitional Agreements"), which will provide for a smooth transition from a corporate structure that includes both companies, and in which certain knowledge or expertise may exist in one or the other company, to two separate and independent publicly traded companies. All of the Transitional Agreements will terminate on or before Date 5.

We have received financial information indicating that Business m (currently conducted through Distributing) and Business n (currently conducted through Controlled) each have had gross receipts and operating expenses representative of an

active trade or business for each of the past five years.

Problems have arisen in connection with Controlled's customers and suppliers who object to doing business with Controlled while Controlled is a subsidiary of Distributing. Distributing has submitted information indicating that the potential loss of income from losing these customers and suppliers is significant. Accordingly, to address these issues, the following transaction was proposed and has been partially consummated:

- (i) On Date 6, Distributing formed Sub 1, a domestic holding company, as a wholly owned subsidiary.
- (ii) On Date 7, Distributing contributed all of its Controlled stock to Sub 1.
- (iii) On Date 8 and Date 9, Distributing contributed cash and certain investment assets to Sub 1.
- (iv) Controlled will form a wholly owned limited liability company and contribute all of its operating assets and liabilities to that limited liability company. Controlled will retain certain investment assets. The limited liability company will be treated as an entity disregarded from Controlled for federal income tax purposes pursuant to an election under § 301.7701-3.
- (v) Sub 1 will contribute the cash it received on Date 8 and Date 9 from Distributing to Controlled. Sub 1 will transfer its other assets to Distributing in connection with a merger of Sub 1 back up into Distributing.
- (vi) Distributing will distribute all of its Controlled stock to its shareholders (the "Distribution"). The Distribution will be pro rata among Distributing common stockholders, Series D stockholders (on an as-converted basis) and Series E stockholders (on an as-converted basis).

Following the proposed transaction both Distributing and Controlled will be publicly owned companies, and Sub 1 will be eliminated.

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

- (a) Any 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 concerning business m represents its present operations, and there have been no substantial operational changes concerning business m since the date of the last financial statements submitted.
- (d) The five years of financial information submitted concerning business n represents its present operations, and there have been no substantial operational changes concerning business n since the date of the last financial statements submitted.
- (e) Following the Distribution, Distributing and Controlled each will continue, independently and with its separate employees, the active conduct of its business.
- (f) The Distribution is carried out for the following corporate business purpose: to resolve problems Controlled has had with customers and suppliers who object to doing business with Controlled because of Distributing's competing business. The Distribution is motivated, in whole or substantial part, by this corporate business purposes.
- (g) There is no plan or intention by any shareholder who owns 5 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 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.
- (h) 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.
- (i) 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 and except that Distributing may sell or otherwise dispose of the assets of Sub 2 either before or after the Distribution.
- (j) No intercorporate debt will exist between Distributing or any of its subsidiaries, and Controlled or any of its subsidiaries, at the time of, or after, the Distribution, other than intercompany payables and receivables between members of the Distributing group incurred in the ordinary course of business.

- (k) 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. Further, any excess loss account Distributing may have in Controlled stock will be included in income immediately before the Distribution.
- (l) Payments made in connection with all continuing transactions, if any, between Distributing or any of its subsidiaries, and Controlled or any of its subsidiaries will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length, except for payments made under the Transitional Agreements.
- (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.

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

- (1) For federal tax purposes, steps (i), (ii), (iii) and (v) above, will be treated as if Distributing transferred cash to Controlled, in constructive exchange for additional stock of Controlled. The transitory existence of Sub 1 will be disregarded. 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) Controlled will recognize no gain or loss on the receipt of the cash in constructive exchange for additional Controlled stock (§ 1032(a)).
- (3) Distributing will recognize no gain or loss on the Distribution (§ 361(c)(1)).
- (4) Distributing's shareholders will recognize no gain or loss and no amounts will be included in their income upon the receipt of the Controlled stock (§ 355(a)(1)).
- (5) The aggregate basis of the Distributing stock and the Controlled stock in the hands of each Distributing shareholder immediately after the Distribution will equal the basis of the Distributing stock held by each

shareholder immediately prior to the Distribution, allocated between the Distributing and Controlled stock in proportion to the fair market value of each immediately after the Distribution in accordance with § 1.358-2(a)(2) (§ 358(a), (b), and (c)).

- (6) The holding period of the Controlled stock received by each Distributing shareholder in the Distribution will include the holding period of the Distributing stock on which the Distribution is made, provided that the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (7) Proper allocation of earnings and profits between Distributing and Controlled will be made under §§ 1.312-10(a) and 1.1502-33.

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.

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 section 12.04 of Rev. Proc. 2002-1, 2002-1 I.R.B. 1, 50, which discusses in greater detail the revocation or modification of ruling letters. However, when the criteria in section 12.05 of Rev. Proc. 2002-1, 2002-1 I.R.B. at 50-51, 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 yours,
Ken Cohen
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Corporate)

cc: