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Legend

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

State X =

Business A =

Business B =

Assets =

Exchange =

Investment Banker =

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a =b =c =d =e =f =

We respond to your request dated July 30, 2001, for rulings about the federal income tax consequences of a proposed transaction. Additional information was provided in a letter dated September 21, 2001. The information submitted for consideration is summarized below.

Distributing is a publicly traded State X corporation and the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing has common stock issued and outstanding and Class A common stock issued and outstanding. Distributing's common stock is traded on the Exchange, while the Class A common stock is privately held, although freely convertible into common stock. Distributing has e shareholders holding more than five percent of the common stock and f shareholders holding more than five percent of the Class A common stock.

Distributing engages in Business A and Business B indirectly through wholly owned subsidiaries, Sub 1, Sub 2, Sub 3, Sub 4, and Sub 5. Sub 1 is primarily engaged in Business A, while Sub 2, Sub 3, and Sub 4 are primarily engaged in Business B. Sub 5 is a holding company that acquires Assets in State X to be used in both Business A and Business B. Sub 3 is also the parent of several subsidiaries all engaged in Business B.

Financial information has been received that indicates that Business A, which will be conducted by Controlled, and Business B, which will be conducted by Distributing, each has 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 concluded and information has been received indicating that the operation of Business A and Business B under the same corporate structure has depressed the stock price of Distributing, thereby adversely affecting Distributing's ability to raise the equity capital necessary to expand Business B and to pay down debt. Based in part on the advice of Investment Banker, Distributing has concluded that the separation of Business A and Business B would enhance Distributing's ability to raise capital.

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To accomplish this objective, the taxpayer has proposed the following transaction (Proposed Transaction):

- (i) Distributing will form Controlled and transfer all of its stock in Sub 1 to Controlled in exchange for all of the Controlled stock (Contribution). Controlled will issue approximately a shares of common stock and b shares of Class A common stock.
- (ii) Distributing will cancel an intercompany receivable of \$c owed by Sub 1 to Distributing. Distributing's existing credit facility will be replaced by two new facilities, one established by Distributing and one established by Controlled.
- (iii) As part of a plan of internal restructuring, Distributing will transfer to Sub 2 all of its stock in Sub 3, Sub 4, and Sub 5 (subsidiaries involved in Business B), as well as all of the intercompany receivables owed to Distributing by Sub 3, Sub 4, and Sub 5. Sub 2 will continue Business B.
- (iv) Distributing will distribute to its shareholders all of the issued and outstanding shares of Controlled on a pro-rata basis (Distribution). Distributing shareholders will not surrender any shares in Distributing. Distributing shareholders will receive d shares of common stock of Controlled for each share of common stock of Distributing and d shares of Class A common stock of Controlled for each share of Class A common stock of Distributing. Any fractional shares will be accumulated by the issuing agent and sold by a stock brokerage firm with the net proceeds going to the respective shareholders in lieu of their fractional shares.

With respect to the Proposed Transaction, the taxpayer has made the following representations:

- (a) The payment of cash in lieu of fractional shares of Controlled will be solely for the purpose of avoiding the expense and inconvenience to Distributing of distributing fractional shares and does not represent separately bargained-for consideration. The total cash consideration to be paid in lieu of fractional shares of Controlled stock will not exceed one percent of the total consideration that will be issued in the transaction to Controlled shareholders. The fractional share interests of each Distributing shareholder will be aggregated and no Distributing shareholder will receive cash in an amount equal to or greater than the value of one full share of common stock of Controlled stock.
- (b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any other

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capacity other than that of a shareholder of Distributing.

- (c) The five years of financial information submitted on behalf of Sub 1 is representative of Sub 1's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) The five years of financial information submitted on behalf of Sub 2 is representative of Sub 2's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2) of the Internal Revenue Code.
- (f) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of the stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (g) Following the Distribution, Sub 1 and Sub 2 each will continue to engage in the active conduct of their respective businesses, independently and with their own separate employees, except that during a period of transition they plan to share certain administrative services and personnel.
- (h) The fair market value of Sub 2's Business B constitutes at least five percent of the total fair market value of all the gross assets of Sub 2. Also, the fair market value of the gross assets of Sub 1's Business A constitutes at least five percent of the total fair market value of all the gross assets of Sub 1.
- (i) The distribution of the stock of Controlled is carried out for the following corporate business purpose: enhancing Distributing's ability to raise capital in the equity markets. The distribution of the stock of Controlled is motivated in whole or substantial part by this corporate business purpose.
- (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

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securities of, either Distributing or Controlled after the Distribution.

- (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 by either Distributing or Controlled, directly or through any subsidiary corporation, to dispose of any of its outstanding stock after the transaction, except for the equity offering by which Distributing intends to raise capital as described above.
- (m) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (n) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (o) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (p) The Distribution is not part of a plan or series of related transactions 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 either Distributing or Controlled, within the meaning of § 355(e).

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- (q) Distributing did not accumulate its receivables or make extraordinary payment of its payables in anticipation of the Distribution of Controlled.
- (r) No intercorporate debt will exist between Distributing and Controlled or Sub 1 at the time of, or subsequent to, the distribution of Controlled's stock.
- (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 §§ 1.1502-13 and 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account, if any, with respect to Controlled's stock will be included in income immediately before the Distribution (see § 1.1502-19).
- (t) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled or Sub 1 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (u) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

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

- (1) The transfer by Distributing to Controlled of the stock of Sub 1, in exchange for the stock of Controlled, followed by the distribution of all of the stock of Controlled to Distributing shareholders will qualify as 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) No gain or loss will be recognized by Distributing on the Contribution (§§ 357(a) and 361(a)).
- (3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).
- (4) The basis of the stock received by Controlled in the Contribution will equal the basis of that stock in the hands of Distributing immediately before its

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transfer (§ 362(b)).

- (5) The holding period for the stock received by Controlled in the Contribution will include the period during which Distributing held that stock (§ 1223(2)).
- (6) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) any Distributing shareholder on receipt of Controlled stock in the Distribution (§ 355(a)(1)).
- (8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of each Distributing shareholder after the Distribution (including any fractional interests to which the shareholder would be entitled) will equal the aggregate basis of the Distributing stock held by the shareholder immediately before the Distribution, allocated between the Distributing stock and Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§§ 358(a)(1), (b)(2), and (c)).
- (9) The holding period of the Controlled stock (including any fractional share interest to which they may be entitled) that each Distributing shareholder receives will include the holding period of the Distributing stock with respect to which the Distribution will be made, provided the Distributing stock is held as a capital asset by such shareholder on the date of the Distribution (§ 1223(1)).
- (10) Proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with §§ 1.312-10(a) and 1.1502-33.
- (11) Where cash is received by a Distributing shareholder in lieu of fractional share interests of Controlled 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 (§ 1001).

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of the Proposed Transaction under any other provision of the Code and regulations which may be applicable thereto, or as to the tax treatment of any conditions existing at the time of, or effects resulting from, the

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Proposed Transaction that are not specifically covered by the above rulings.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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.

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this letter are consummated and to any income tax return to which it is relevant.

Sincerely yours,
Filiz A. Serbes
Chief, Branch 3
Office of Associate Chief Counsel
(Corporate)