

## Internal Revenue Service

## Department of the Treasury

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Date:

**May 14, 2001**

### Legend

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Financial Advisor =

Business A =

Business B =

State X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

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a =b =c =d =

This is in response to your letter dated October 27, 2000, requesting rulings on behalf of Distributing with respect to a proposed and partly consummated transaction. Additional information was received in letters dated January 10, 2000, February 1, 2001, February 23, 2001, March 5, March 26, 2001, April 24, 2001 and May 8, 2001. The material information submitted is summarized below.

Distributing is a State X corporation which is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year basis. Only one class of Distributing stock is outstanding. Distributing's stock is publicly traded and widely held.

Controlled is a State X corporation that was formed on Date 1 in connection with the transaction discussed below. Only one class of Controlled stock is outstanding. Until Date 6, all of the outstanding Controlled stock was owned by Distributing.

Distributing is engaged, directly and through its subsidiaries (other than Controlled and Controlled's subsidiaries) in Business A. Controlled is engaged in Business B, directly and through its subsidiaries Sub 1, Sub 2, Sub 3, and Sub 4. Controlled owns 100% of the stock of Sub 1, Sub 3, and Sub 4, and a% of the stock of Sub 2. Controlled, Sub 2, Sub 3, and Sub 4 are directly engaged in Business B. Sub 1 is a holding company that holds b% of the stock of Sub 5, which is directly engaged in Business B. Controlled acquired the stock of Sub 3 on Date 2, and it acquired the stock of Sub 4 on Date 3, in transactions that Distributing believes qualify as tax-free reorganizations under section 368(a) of the Code. Financial information has been received indicating that Business A and Business B each have had gross receipts and operating expenses representing the active conduct of a trade or business during each of the past five years.

Distributing has determined that Business B would be better positioned to grow if it were completely separated from the Distributing group, partly because, as Distributing's Financial Advisor has advised Distributing, Controlled can raise needed equity capital more efficiently if such a separation occurs. In order to achieve that separation, Distributing formed Controlled on Date 1. On Date 4 and Date 5, Distributing contributed assets relating to Business B to Controlled in constructive exchange for additional shares of Controlled common stock and in exchange for the assumption by Controlled of liabilities associated with Business B. Specifically, on Date 4, Distributing transferred to Controlled the stock of Sub 2 and on Date 5, Distributing

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transferred to Controlled Distributing's Business B division and the stock of Sub 1. (The Date 4 and Date 5 transfers are collectively referred to hereafter as the "Contribution.") In order to raise the equity capital needed for growth, there occurred on Date 6 a public offering of c shares or approximately d% of Controlled stock (the "Offering"). In order to accomplish the separation of Business B from the Distributing group, Distributing proposes to distribute its Controlled stock pro rata to its shareholders (the "Distribution") by the later of (1) twelve months following the Offering or (2) three months following receipt of this letter ruling on the Distribution. No Distributing shareholder will surrender Distributing stock in the transaction.

No fractional shares of Controlled will be distributed in the Distribution. In lieu of issuing fractional shares to Distributing shareholders, Distributing will cause all Distributing shareholders' fractional shares to be aggregated and sold on the open market by a distribution agent as soon as practicable after the Distribution. The holders entitled to fractional share interests will receive their pro rata portions of the cash proceeds from the sale.

Employees, directors, and consultants of Distributing and its subsidiaries, including Controlled and its subsidiaries, currently hold a number of options to acquire Distributing stock. Concurrently with the Distribution, Controlled intends to grant "New Controlled Options" to substantially all of the employees, directors, or consultants of Controlled and Distributing who hold options to acquire Distributing common stock granted before Date 5. Distributing intends simultaneously to adjust the economic terms of such Distributing options (the "Modified Distributing Options"). The New Controlled Options and the Modified Distributing Options are intended, in the aggregate, to result in each recipient holding such options in a number and at prices necessary to maintain each such recipient's pre-Distribution economic position.

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

- (a) The payment of cash in lieu of fractional shares of Controlled is solely for the purpose of avoiding the expense and inconvenience of issuing fractional shares and does not represent separately bargained for consideration. The method used for handling fractional shares is designed to limit the amount of cash received by any one shareholder to less than the value of one full share of Controlled stock. The total amount of cash paid in lieu of fractional shares will not exceed one percent of the fair market value of Controlled stock distributed to Distributing's shareholders in the Distribution.
- (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 the corporation.

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- (c) No part of the consideration to be distributed by Distributing will be received by a security holder as a creditor, employee, or in any capacity other than that of a security holder of the corporation.
- (d) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operation, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) The five years of financial information submitted on behalf of Controlled is representative of Controlled's present operation, and with regard to such operations, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (g) The distribution of the stock of the controlled corporation is carried out for the following corporate business purpose: to raise significantly more equity capital than would be possible without the planned Distribution. The distribution of the stock of the controlled corporation is motivated, in whole or substantial part, by this corporate business purpose.
- (h) 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 the distributing corporation to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the transaction.
- (i) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase its outstanding stock after the transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (j) There is no plan or intention to liquidate either the distributing or the controlled corporation, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (k) The Distribution is not a part of a plan or series of related transactions (within the meaning of Code section 355(e)), pursuant to which one or

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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.

- (l) It is not reasonably certain that before a date that is six months after the Distribution, stock representing a fifty percent or greater interest in Distributing will be acquired pursuant to the conversion of the Convertible Notes.
- (m) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled (within the meaning of section 357(d)) plus any liabilities to which the transferred assets are subject.
- (n) The liabilities assumed in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.
- (o) Distributing neither accumulated its receivables nor made extraordinary payment of its receivables in anticipation of the transaction.
- (p) Except for payables and receivables arising in the ordinary course of business, no intercorporate debt will exist between Distributing and Controlled at the time or, or subsequent to, the distribution of the Controlled stock.
- (q) Immediately prior to 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 of the Income Tax Regulations (the “Regulations”) 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 the Controlled stock will be included in income immediately before the distribution (see § 1.1502-19 of the Regulations).
- (r) Except as provided in the Tax Sharing Agreement, 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.
- (s) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

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Based solely on the information submitted and the representations made, we have concluded that:

- (1) The Contribution, followed by the Distribution, will constitute a reorganization within the meaning of section 368(a)(1)(D) of the Internal Revenue Code. Distributing and Controlled will each be a “party to the reorganization” within the meaning of section 368(b).
- (2) No gain or loss will be recognized by Distributing upon its receipt of Controlled stock in exchange for the transfer of assets to, and the assumption of liabilities by, Controlled in the Contribution. Section 361(a) and (b) and section 357(a).
- (3) No gain or loss will be recognized by Controlled upon its receipt of assets in exchange for its issuance of shares of Controlled stock in the Contribution. Section 1032.
- (4) Controlled’s basis in each asset received from Distributing in the Contribution will equal the basis of such asset in the hands of Distributing immediately prior to the transfer. Section 362(b).
- (5) The holding period of each asset received by Controlled from Distributing in the Contribution will include the period during which Distributing held such asset provided such asset is a capital asset as defined in section 1221 or property described in section 1231 in the hands of Distributing. Section 1223(1).
- (6) Distributing will not recognize gain or loss upon the distribution to its shareholders of the stock in Controlled in the Distribution. Sections 355(c), 355(d), 355(e), and 361(c)(1).
- (7) No gain or loss will be recognized to (and no amounts will be included in the income of) the shareholders of Distributing upon their receipt of Controlled stock. Section 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 will equal the aggregate adjusted basis of the Distributing stock held immediately before the Distribution, allocated in proportion to the fair market value of each under Treas. Reg. § 1.358-2(a)(2).
- (9) The holding period of the Controlled stock received by the shareholders of Distributing will, in each instance, include the holding period of the Distributing stock with respect to which the Distribution will be made, provided that the Distributing stock is held as a capital asset by the

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respective shareholder of Distributing on the day of the Distribution.  
Section 1223(1).

- (10) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with §§ 1.312-10 and 1.1502-33 of the Regulations.
- (11) If cash is received by a Distributing shareholder as a result of sale of a fractional share of Controlled stock by the distribution agent, the shareholder will have gain or loss measured by the difference between the basis of the fractional share, as determined in ruling (9) above, and the amount of cash received. If the Controlled stock is held by the shareholder as a capital asset at such time, the gain or loss will be capital gain or loss subject to the provisions and limitations of Subchapter P of the Code. See sections 1221 and 1222.
- (12) Any payments under the Tax Sharing Agreement made by Distributing to Controlled or by Controlled to Distributing that (i) relate to a period ending on or before the date of the Distribution and (ii) will not become fixed and determinable until after the Distribution will be treated as occurring immediately before the Distribution.
- (13) The holders of Distributing options will not recognize any income, gain, or loss upon the receipt of the New Controlled Options and Modified Distributing Options pursuant to the Distribution.
- (14) Distributing will recognize no gain or loss upon a Distributing employee's or service provider's exercise of an option to acquire Distributing stock. Sections 361(c) and 1032.
- (16) Controlled will recognize no gain or loss upon a Controlled employee's or service provider's exercise of an option to acquire Controlled stock. Sections 361(c) and 1032.
- (17) Controlled will recognize no gain or loss upon a Controlled employee's or service provider's exercise of an option to acquire Distributing stock. Sections 361(c) and 1032 and § 1.1032-3.

No opinion is expressed as to the tax treatment of the transactions under other provisions of the Code or 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. Specifically, no opinion was requested and none is expressed as to whether the acquisitions by Controlled of Sub 3 and Sub 4 qualify as reorganizations under section 368(a) of the Code. Further, no opinion is expressed as

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to whether Distributing will recognize gain or loss upon the exercise by a Distributing employee or service provider of an option to acquire Controlled stock.

In accordance with a power of attorney on file in this office, copies of this letter are being sent to your authorized representatives.

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.

Sincerely yours,  
Associate Chief Counsel (Corporate)  
By: Edward S. Cohen  
Chief, Branch 2 (Corporate)