

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Date: January 28, 1999

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Business A =

Date B =

Date C =

Date D =

State E =

State F =

Service G =

Service H =

License I =

Agreement J =

Agreement K =

Corporation X =

Corporation Y =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

n =

o =

p =

q =

This letter is in response to your request, dated September 28, 1998, for rulings relating to the federal income tax consequences of a proposed transaction. You submitted additional information in letters dated November 24, 1998 and January 14, 1999. The information submitted for consideration The information provided in that request and in later correspondence is substantially as set forth below.

Distributing was established on Date B as a State E corporation. Distributing is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year, accrual method basis.

As of Date C, Distributing had authorized a shares of common stock, of which b shares of class A common stock and c shares of class B common stock were outstanding, and d shares of preferred stock, of which e shares were outstanding. The class A common stock and the class B common stock are identical, except that the class A common stock carries one vote per share and the class B common stock carries ten votes per share, and the class B common stock is convertible into class A common stock on a one-for-one basis. Both the class A common stock and the class B common stock is widely held and the class A common are publicly traded on a national stock exchange. As of Date D, there were approximately f and g record holders of class A common stock and class B common stock respectively. As of Date C, four of Distributing's current shareholders beneficially own five percent or more of Distributing's outstanding common stock.

As of Date C, Distributing had outstanding employee options to acquire h shares of its class A common stock, participants in a joint venture with a subsidiary of Distributing have the right to convert their joint venture interest into i shares of class A common stock, and an officer of Distributing had the right to convert an interest in a

Distributing affiliate into approximately j shares of Distributing class A common stock.

Controlled was incorporated in State F as a subsidiary of Distributing. Controlled has authorized k shares of common stock, of which l shares are outstanding. Distributing owns m shares (an amount greater than 80 percent) of Controlled's outstanding stock. Corporation X owns n shares of Controlled's outstanding stock.

Sub 1 is a State F corporation all of whose stock is owned by Controlled.

Sub 2 is a State F corporation all of whose outstanding stock is owned by Sub 1.  
Sub 3 is a State F corporation all of whose outstanding stock is owned by Sub 2.

Sub 4 is a State F corporation all of whose outstanding stock is owned by Distributing.

Sub 5 is a State F corporation all of whose outstanding stock is owned by Sub 4.

Business A consists of two different services: Service G and Service H. Both Service G and Service H are provided to subscribers on the same basis. Distributing and Controlled are actively engaged directly and through indirect subsidiaries in Business A. More specifically, Distributing, Sub 4, and Sub 5 provide Service G (but not Service H) and Controlled, Sub 1, Sub 2, and Sub 3 provide Service H (but not Service G).

Distributing has submitted data indicating that the Active Business (Business A) of both Controlled and Distributing has been conducted continuously during the past five years.

To remain competitive it is imperative for Distributing to expand its operations. Distributing believes, and has submitted supporting documentation and analysis in support of its assertions, that the only way for it to expand is to acquire interests in License I that are reserved for use by small businesses or specified minority groups. The most efficient means of acquiring those interests is through the preservation of two existing joint ventures between Controlled and Corporation Y.

The first joint venture between a Controlled affiliate and a partnership controlled by Corporation Y owns License I. The second joint venture between a Controlled affiliate and Corporation Y will participate in the purchase of License I at auction.

In the first joint venture, Corporation Y obtained liquidity for its interests in the first joint venture by demanding the right to convert such interests into Distributing stock. Now, because Corporation Y wants to invest for the opportunity to participate solely in Service H, not Service G, Corporation Y has demanded the right to convert its interests in both the first joint venture and the second joint venture into publicly traded Controlled stock as a condition of finalizing the second joint venture. However,

Corporation Y will not accept such Controlled stock if Controlled is controlled by a single shareholder that owns more than approximately 0 percent of Controlled's stock. Moreover, if Corporation Y is forced to accept Distributing stock rather than Controlled stock in exchange for its joint venture interests, it demanded that a "premium" amount of Distributing stock (a penalty) be paid.

The proposed transaction will help preserve the second joint venture and help to assure Controlled's continuing access to License I, without requiring Distributing to pay the penalty price for Corporation Y's joint venture interests. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.

Accordingly, the following transaction is proposed:

- (1) Sub 5 will transfer all of its assets, subject to all of its liabilities to a newly formed State F limited liability company all of whose membership interests are owned by Sub 5 ("LLC 1"). Thereafter Sub 5 will transfer all of its assets, subject to all of its liabilities, to Sub 4 in complete liquidation of Sub 5.
- (2) Sub 4 will transfer all of its assets (including its membership interest in LLC 1), subject to all of its liabilities, to a newly formed State F limited liability company all of whose membership interests are owned by Sub 4 ("LLC 2"). Thereafter, Sub 4 will transfer all of its assets (including its membership interest in LLC 2), subject to all its liabilities, to Distributing in complete liquidation of Sub 4. Following the liquidation, all of the membership interest in LLC 2 will be owned by Distributing and both LLC 1 and LLC 2 will be treated as a division of Distributing for federal income tax purposes under Treasury Regulations section 301.7701-3.
- (3) Contemporaneously, Sub 3 will transfer all of its assets, subject to all of its liabilities, to a newly formed Delaware limited liability company all of whose membership interests are owned by Sub 3 ("LLC 3"). Thereafter, Sub 3 will transfer all of its assets (including its membership interest in LLC 3), subject to all of its liabilities, to Sub 2 in complete liquidation of Sub 3.
- (4) Sub 2 will transfer all of its assets (including its membership interest in LLC 3), subject to all of its liabilities, to a newly formed Delaware limited liability company all of whose membership interests are owned by Sub 2 ("LLC 4").
- (5) Sub 2 will distribute all of its assets (including its membership interest in LLC 4), subject to all of its liabilities, to Sub 1 in complete liquidation. Thereafter, Sub 1 will transfer all of its assets (including its membership

interest in LLC 4), subject to all of its liabilities, to a newly formed Delaware limited liability company all of whose membership interests are owned by Sub 1 ("LLC 5").

- (6) Sub 1 will distribute all of its assets (including its membership interest in LLC 5), subject to all of its liabilities, to Controlled in complete liquidation of Sub 1. Following the liquidation, all of the membership interests in LLC 5 will be owned by Controlled, and LLC 5, LLC 4, and LLC 3 will be treated as a division of Controlled for federal income tax purposes under Treasury Regulations section 301.7701-3.
- (7) Distributing will distribute all of the stock of Controlled pro rata to Distributing's shareholders (the "Spin-off"). Each share of Distributing class A common stock will be treated the same as each share of Distributing class B common stock in the Spin-off. Immediately following the Spin-off, Controlled's stock will be publically traded on the national over-the-counter market.
- (8) It is presently contemplated that vested employee options to acquire Distributing stock would be converted into options to acquire both Distributing and Controlled stock following the Spin-off; and that non-vested employee options to acquire Distributing stock held by employees of Controlled would be converted into options to acquire Controlled stock following the Spin-off.
- (9) Following the Spin-off, Distributing and its affiliates are expected to have approximately p employees and Controlled and its affiliates are expected to have approximately q employees. Distributing and Controlled will each have separate employees to handle the following functions: sales, marketing, engineering, customer care, customer financial services, information technology, legal, regulatory, corporate development, finance, and human resources. Distributing and Controlled will also each employ its own separate president and vice president following the Spin-off. In addition, in order to avoid undue disruption of the Distributing and Controlled business following the Spin-off, Distributing and Controlled will share their chief financial officer and general counsel for a transition period following the Spin-off. The transition period will terminate promptly, but in no event more than 12 month following the Spin-off. In addition, Distributing's chief executive officer will act as the chief executive officer of Controlled following the Spin-off, on a split payroll basis.
- (10) Distributing presently provides cash management services to Controlled pursuant to a cash management agreement, and provides certain management and operational services to Controlled pursuant to a services agreement. There may be a transition period following the Spin-

off during which these agreements are continued in order to avoid undue disruption of the Controlled business. This transition period (if any) is not expected to exceed 12 months.

- (11) Distributing and Controlled presently have an arm's length Agreement J. This agreement will remain in place following the Spin-off.
- (12) Distributing and Controlled initially will have significant overlap among their shareholders following the Spin-off and are expected to have at least five common board members (including the chairman of each board). It is expected that each company will have at least two non-overlapping board members.
- (13) Following the Spin-off, Distributing and Controlled expect to enter into an arm's length Agreement K.

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

- (a) No indebtedness will be owed by Controlled to Distributing after the Spin-off, with the exception of recurring trade payables and short term post spin-off obligations (for example, any amounts to be paid under the parties' tax-sharing agreement).
- (b) No Distributing stock will be surrendered in the Spin-off.
- (c) 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.
- (d) No part of the consideration to be distributed by Distributing will be received by a security holder.
- (e) The five years of financial information submitted on behalf of Sub 5 and the Distributing Active Business and the financial information submitted on behalf of Sub 2 and the Controlled Active Business are representative of their present operation, and with regard to such corporations, 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, independently and with its separate employees (except as described above), the active conduct of its share of all the integrated activities of the business conducted by Distributing directly and indirectly through subsidiaries prior to the consummation of the transaction, except as described above.

- (g) The distribution of the stock of Controlled is carried out for the following corporate business purposes: it will help to preserve the second joint venture and help to assure Controlled's continuing access to License I, without requiring Distributing to pay the penalty price for Corporation Y's joint venture interest. The distribution of the stock of Controlled 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 Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the transaction; except that after the transaction two five percent shareholders of Distributing that are limited partnerships may distribute stock of Distributing or Controlled or both to their partners in accordance with the terms of their partnership agreements.
- (i) 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 section 4.05(1)(b) of Rev. Proc. 96-30.
- (j) 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 transaction, except in the ordinary course of business.
- (k) Taking into account sections 355(d)(6), (7), and (8), no person has acquired by purchase 50 percent or more of the total combined voting power or total combined value of the stock of Distributing and Controlled.
- (l) The Spin-off is not part of a plan or series of related transactions (within the meaning of section 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 either Distributing or Controlled.
- (m) (i) The total adjusted bases and the fair market value of the assets, if any, transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject; and



- (ii) The liabilities assumed in the transaction and the liabilities to which the transferred assets, if any, are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (n) 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.
- (o) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (p) No income items, including accounts receivable or any item resulting from a sale, exchange or disposition of property, that would have resulted in income to Distributing, and no items of expenses will be transferred to Controlled if Distributing has earned the right to receive the income or could claim a deduction for the expenses under the accrual or similar method of accounting.
- (q) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Spin-off except as set forth in representation (a).
- (r) 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, 1995-2 C.B. 147, and as currently in effect, § 1.1502-13 as published by T.D. 8597). Further, Distributing does not have an excess loss account with respect to Controlled's stock (See § 1.1502-19).
- (s) 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.
- (t) 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) Distributing will recognize no gain or loss upon the distribution of all of Controlled stock that it owns in the Spin-off (section 355(c)).
- (2) The shareholders of Distributing will recognize no gain or loss (and no amount will be included in their income) upon their receipt of Controlled stock in the Spin-off (section 355(a)(1)).
- (3) The basis of the Distributing stock and the Controlled stock distributed in the Spin-off in the hands of the Distributing shareholders after the distribution will, in each instance, be the same as the aggregate basis of the Distributing stock held immediately before the distribution, allocated in proportion to the fair market value of each in accordance with Treasury Regulations section 1.358-2(a)(2) (section 358(a)(1)).
- (4) The holding period of the Controlled stock received by the Distributing shareholders in the Spin-off will, in each instance, include the holding period of their Distributing stock with respect to which the distribution is made, provided that the Distributing stock is held as a capital asset on the date of the distribution (section 1223(1)).
- (5) As provided in section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under section 1.312-10(b) and section 1.1502-33(e)(3) of the Income Tax Regulations.

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

We express no opinion as to the tax treatment of the transaction under other provisions of the Code and regulations, or as to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings.

This ruling letter is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. Each affected taxpayer must attach a copy of this letter to the federal income tax return for the taxable year(s) in which the transaction covered by this letter ruling are consummated.

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

Sincerely yours,

Assistant Chief Counsel (Corporate)

By *Victor Penico*

Victor Penico  
Chief, Branch 3