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PLR-151750-07

Date:

March 21, 2008

LEGEND:

Distributing =

Controlled =

Newco =

Subsidiary =

Finance =

LLC =

Shareholder 1 =

Shareholder 2 =

Corporation Y =

Corporation Z =

State X =

Country W =

Country U =

Territory =

Business A =

Activity B =

Product D =

Product E =

Product F =

Property =

LLC Products =

Property Lease =

Date =

a =

b

=

Dear :

This letter responds to your November 21, 2007 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and its shareholders and accompanied by penalties of perjury statements executed by the appropriate parties. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. Moreover, this office has not reviewed any information pertaining to, and has made no determination regarding whether the Distribution (as defined below): (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, (ii) is being used principally as a device for the distribution of the earnings and profits of the distributing corporation, the controlled corporation, or both (see § 355(a)(1)(B) of the Internal Revenue Code (the "Code")) and § 1.355-2(d), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e) and § 1.355-7).

Summary of Facts

Distributing is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing is engaged, directly and through its subsidiaries, in Business A. Financial information has been received indicating that Business A, and each of Product D and Product E, its two primary commercial activities, have had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years. As part of Business A, Distributing is engaged in Activity B with respect to certain other products, including Product F.

Distributing owns all of the stock of Subsidiary and Finance, both of which are domestic corporations. Subsidiary provides sales and distribution services to Distributing's Business A. Finance is directly engaged in financing receivables of Subsidiary.

Shareholder 1, a publicly traded domestic corporation, and Shareholder 2, each owns 50 percent of the outstanding Distributing stock. Shareholder 2, a domestic corporation is owned by Corporation Z, a publicly traded Country W corporation. Shareholder 2, is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Shareholder 2 owns all the stock of Corporation Y which is engaged in a business similar to Business A.

Shareholder 1 and Shareholder 2 have had significant disagreements regarding the management of Business A that have adversely affected Business A, resulting in a substantial diminution of its value. Each of Shareholder 1 and Shareholder 2 believes that Business A would be more successful under its control and direction. Accordingly, Shareholder 1, Shareholder 2, and Distributing have agreed to divide Business A.

Proposed Transaction

For what are represented to be valid business reasons, the following steps have been proposed to divide Business A (collectively, the "Proposed Transaction"):

(i) Finance will merge into Distributing in a transaction intended to qualify as liquidation under § 332 (the "Finance Merger").

(ii) Subsidiary will contribute its workforce-in-place connected with Product D, as well as certain other employees to be identified (collectively, the "Subsidiary Employees"), to Newco, a newly-formed, wholly-owned domestic corporation, in actual or constructive exchange for all of the Newco stock and Newco's assumption of any liabilities connected with the Subsidiary Employees (the "Subsidiary Contribution").

(iii) Subsidiary will distribute all of the stock of Newco to Distributing in a transaction intended, together with Step (ii) above, to qualify as a reorganization under §§ 368(a)(1)(D) and 355 (the "Subsidiary Distribution").

(iv) Distributing and Subsidiary will form LLC, a State X limited liability company. Distributing will contribute its entire interest in Property associated with certain products to LLC in exchange for LLC Interest A and LLC Interest B having an aggregate fair market value equal to the value of the Property contributed to LLC (hereafter, the "LLC Products"). Subsidiary will contribute cash of \$a in exchange for LLC Interest C having a fair market value equal to \$a. It is intended that LLC will qualify as a partnership for U.S. federal income tax purposes, and will be treated as such by Distributing, Subsidiary, and Controlled.

(v) Distributing will transfer to a newly-formed Controlled its workforce-in-place connected with Product D (the "Controlled Employees") and the following assets: (a) all assets primarily related to Distributing's activities regarding Product D; (b) all of the stock of Newco; (c) a building and related land; (d) Product F agreements; (e) all of LLC Interest B; and (f) an amount of cash, if any, required to equalize the estimated accounting net worth of Distributing and Controlled immediately following the Proposed Transaction (the "Estimated Net Asset Equalization Amount") in exchange for the actual or constructive issuance of Controlled stock and the assumption of liabilities associated with Product D, the Controlled Employees, and certain other specified liabilities (the "Contribution"). Depending on the actual assets and liabilities to be divided, Distributing may retain certain accounts receivable relating to Product D so that the Estimated Net Asset Equalization Amount to be contributed to Controlled will not be negative. The amount of cash transferred to Controlled will also be

adjusted by a fixed amount depending on when the Distribution described below occurs after Date (the "Time Adjustment Amount").

(vi) Distributing will distribute all of the shares of Controlled stock to Shareholder 1 in exchange for all of Shareholder 1's stock in Distributing (the "Distribution").

Shortly after the Distribution, a formal audit of the accounts of Distributing and Controlled as of the date of the Distribution will be undertaken; as a result of such audit, Distributing may transfer to Controlled, or Controlled may transfer to Distributing, amounts necessary to effectuate a 50-50 division of the assets (the "Net-Worth Adjustment").

Distributing, as the holder of LLC Interest A, will have the sole right to manage LLC. LLC Interest C will have the same economic rights as LLC Interest A but will not have any management rights. LLC Interest B will be entitled to allocations of LLC gross income based on a percentage of future net sales of LLC Products and additional fixed allocations depending on whether certain events occur in the development of some of the LLC Products, each such allocation subject to increase by a defined factor. LLC Interest B will be entitled to corresponding distributions of amounts equal to the amounts of such income allocations. LLC Interest B will be allocated a specified amount of LLC gross expenses if certain events do not occur with respect to some of the LLC Products by certain dates, each such allocation subject to increase by a defined factor, and will be required to make contributions to LLC capital in the amounts so allocated. LLC Interest B will terminate after the final payments are made under the terms of the Transaction Agreements (as defined below), approximately months after the Distribution.

In connection with the Distribution, Distributing, Controlled, LLC, Shareholder 1, and Shareholder 2 will enter into agreements that will govern the Distribution and the relationships between the parties subsequent to the Distribution including with respect to the LLC (collectively, the "Transaction Agreements"). Certain of the Transaction Agreements will provide for the allocation of certain assets and certain liabilities and obligations arising from periods prior to the Distribution, including certain tax and employee-related matters of Distributing and its subsidiaries (the "Allocation Agreements"). Certain of the Transaction Agreements (which may include the Allocation Agreements) will govern continuing relationships of Distributing and Controlled following the Distribution with each other or affiliates of each other, all of which will be based on terms and conditions arrived at by parties bargaining at arm's length (the "Continuing Transaction Agreements"). The Continuing Transaction Agreements will include agreements for: (i) the provision of transition services between Distributing, Controlled, and their respective affiliates; (ii) a Property Lease from Controlled to Distributing; (iii) an agreement regarding the license and supply agreement of Product D by Corporation Z to Controlled; (iv) agreements between Distributing and Shareholder 1 for the preparation and packaging of Product E and possibly other products; and (v) agreements between Distributing and affiliates of Shareholder 1 regarding the distribution of Product E in Territory and Country U. Certain of the Transaction Agreements relate to LLC (the "LLC Agreements"). The LLC Agreements will include an agreement regarding LLC's operations, management, and ownership and other agreements with respect to its supply of, and enabling it to sell, LLC Products, including a

services agreement with Subsidiary and Distributing to sell these products, a supply agreement with Distributing, a distribution agreement with Distributing, and other relevant agreements.

Taking into account all transfers of cash from Distributing to Controlled or Controlled to Distributing made prior to the Distribution (including the Estimated Net Asset Equalization Amount and the Time Adjustment Amount), and all such payments made following the Distribution pursuant to the Net-Worth Adjustment or the Allocation Agreements, if the total cash that Distributing received from Controlled pursuant to such items exceeds the total cash that Distributing contributed to Controlled pursuant to such items (the "Net Excess"), Distributing will either (a) distribute the Net Excess to Shareholder 2, or (b) transfer the Net Excess to creditors of Distributing. Distributing will not transfer to Shareholder 2 or to Distributing creditors an amount of the Net Excess that exceeds the basis of the assets that Distributing transferred to Controlled in the Contribution, reduced by the liabilities assumed (as determined under § 357(d)) by Controlled in connection with the Distribution.

It is expected that at some point following the Proposed Transaction, Distributing will merge or otherwise combine with Corporation Y, a wholly owned subsidiary of Shareholder 2, in what will be intended to be a tax-free reorganization within the meaning of § 368(a)(1), and certain assets and operations of Distributing will be contributed to one or more wholly owned subsidiaries of Corporation Y (the "Corporation Y Merger"). In such event, it is expected that the surviving corporation (the "Surviving Corporation") of such a combination would continue to conduct the activities with respect to Product E (and Distributing's other activities) and the business of Corporation Y, either directly or indirectly through one or more wholly owned subsidiaries. Any reference to Distributing in this letter ruling shall include a reference to the Surviving Corporation, as appropriate.

Representations

Distributing makes the following representations in connection with the Proposed Transaction:

- (a) The indebtedness, if any, owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (b) The fair market value of the Controlled stock to be received by Shareholder 1 in the Distribution will approximately equal the fair market value of the Distributing stock to be surrendered by Shareholder 1 in the exchange.
- (c) No part of the consideration to be distributed by Distributing will be received by Shareholder 1 as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (d) Neither Business A nor any entity conducting Business A was acquired during the five year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.

- (e) The five years of financial information submitted on behalf of Business A is representative of its present operations, and, with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) After the Distribution, Distributing and Controlled, or members of their respective separate affiliated group ("SAG," as defined by § 355(b)(3)(B)) or (in the case of Distributing, LLC) will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of Business A conducted by Distributing prior to the consummation of the Proposed Transaction.
- (g) The Distribution is being undertaken for corporate business purposes that include the elimination of systemic issues arising from the 50-50 ownership of Distributing, the elimination of management disagreements, and the achievement of synergies anticipated from the combination of Distributing's businesses with those of its shareholders. The Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (h) The Distribution is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (i) Immediately after the Distribution, the total fair market value of the assets transferred to Controlled in the Contribution will exceed the sum of (i) the amount of any liabilities assumed (as determined under § 357(d)) by Controlled in the Contribution, (ii) the amount of any liabilities owed by Distributing to Controlled that are discharged or extinguished in connection with the Contribution, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing in connection with the Contribution (including the Net Excess, if any). The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the Distribution.
- (j) The total adjusted basis and the fair market value of the assets to be transferred to Controlled by Distributing pursuant to the Contribution each will equal or exceed the sum of the liabilities to be assumed (as determined under § 357(d)) by Controlled and (ii) the total of any money and the fair market value of any other property (within the meaning of § 361(b)) transferred by Controlled to Distributing that is to be distributed to the shareholder of Distributing or transferred to the creditors of Distributing pursuant to the plan of reorganization.
- (k) The liabilities to be assumed (as determined under § 357(d)) by Controlled pursuant to the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.

- (l) The income tax liability for the taxable year in which any investment credit property (including any building to which § 47(d) applies) is transferred pursuant to the Contribution will be adjusted as appropriate pursuant to § 50(a)(1) or 50(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.
- (m) No indebtedness will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, except for indebtedness arising in the ordinary course of business, including indebtedness arising pursuant to the Transaction Agreements.
- (n) 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 of the Income Tax Regulations 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 in T.D. 8597). Distributing's excess loss account with respect to the stock of Controlled, if any, including any excess loss account created or increased as a result of any Transaction Agreement, will be included in income of Distributing, as appropriate (see § 1.1502-19).
- (o) Payments made in connection with all continuing transactions, if any, between (a) Distributing and Controlled, (b) Corporation Z, Shareholder 1, or any of their affiliates and Distributing, or (c) Corporation Z, Shareholder 1, or any of their affiliates and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (p) Neither Distributing nor Controlled is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).
- (q) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation). This representation also applies if the Corporation Y Merger is treated as a part of a plan or series of related transactions that includes the Distribution (see § 355(e)(3)(A)(iv)).
- (r) Distributing and Controlled each will pay its own expenses incurred in connection with the Proposed Transaction.
- (s) 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.

- (t) 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 any stock of Distributing 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.
- (u) Distributing, Controlled, and Subsidiary will treat LLC as a partnership for federal tax purposes and will allocate the items of gross income and gross expense in the manner described above.
- (v) Immediately after the Proposed Transaction (as defined in § 355(g)(4)), either (i) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)), or (ii) no person will hold a 50-percent or greater interest (within the meaning of § 355(g)(3)) in the stock of Distributing or Controlled that such person did not hold immediately before the Distribution.

Rulings

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

- (1) The Contribution, followed by the Distribution, will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be “a party to a reorganization” within the meaning of § 368(b).
- (2) Distributing will not recognize any gain or loss on the Contribution (§§ 361(a) and 357(a)). Provided that Distributing either distributes any Net Excess to Shareholder 2 or transfers it to Distributing creditors (such that the aggregate amount distributed to Shareholder 2 or transferred to creditors does not exceed the basis of the assets that Distributing contributed to Controlled in the Contribution, such basis to include net cash transferred pursuant to the payments from Distributing to Controlled described in ruling (11) below, reduced by the liabilities assumed (as determined under § 357(d)) by Controlled in the Contribution), Distributing will not recognize any gain on the Contribution attributable to the receipt of Net Excess payments pursuant to § 361(b) (§ 361(b)(1) and (b)(3)).
- (3) Controlled will not recognize any gain or loss on the Contribution (§ 1032(a)).

- (4) Controlled's basis in the assets received from Distributing in the Contribution will equal the basis of such assets in the hands of Distributing immediately before their contribution to Controlled (§ 362(b)).
- (5) Controlled's holding period in the assets received from Distributing in the Contribution will include the period during which Distributing held such assets (§ 1223(2)).
- (6) Distributing will recognize no gain or loss on the Distribution (§ 361(c)).
- (7) Shareholder 1 will recognize no gain or loss (and will not include any amount in income) on the Distribution (§ 355(a)(1)).
- (8) Shareholder 1's basis in the stock of Controlled received in the Distribution will equal the basis of the Distributing stock that Shareholder 1 surrenders in exchange therefor (§ 358(a)).
- (9) Shareholder 1's holding period of all of the stock of Controlled received in the Distribution will include the holding period of the stock of Distributing surrendered in the exchange, provided that Shareholder 1 held such Distributing stock as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) Distributing and Controlled will allocate their earnings and profits in accordance with § 312(h) and §§ 1.312-10(a) and 1.1502-33(e)(3).
- (11) Payments made pursuant to the Allocation Agreements by Distributing to Controlled or by Controlled to Distributing following the Distribution for: (a) items that (i) have arisen or will arise for a taxable period ending on or before the Distribution or for a taxable period beginning before and ending after the Distribution, and (ii) will not become fixed and ascertainable until after the Distribution; or (b) the Net-Worth Adjustment will be treated as adjustments to amounts contributed by Distributing to Controlled or distributed by Controlled to Distributing immediately before the Distribution (*see Arrowsmith v. Commissioner*, 344 U.S. 6 (1952)).
- (12) Controlled will not be a successor to Distributing for purposes of § 1504(a)(3).

Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under any other provision of the Code or Regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the rulings.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Distribution: (i) satisfies the business

purpose requirement of §1.355-2(b), (ii) is being used principally as a device for the distribution of earnings and profits of Distributing or Controlled or both (see § 355(a)(1)(B) and § 1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest in Distributing or Controlled (see § 355(e) and § 1.355-7). Also, no opinion was requested, and none is expressed, regarding the tax treatment of the Finance Merger, the Subsidiary Contribution, the Subsidiary Distribution, LLC, or the Corporation Y Merger.

Procedural Statements

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income return for which it is relevant. Alternatively, any taxpayer filing its return electronically may satisfy this requirement by attaching a statement to the return that provides the date and control number of this letter ruling.

In accordance with the power of attorney on file in this office, a copy of this ruling will be sent to your authorized representatives.

Sincerely,

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Corporate)