

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Distributing =

Controlled =

Sub 1 =

LLC 1 =

LLC 2 =

Business A =

Business B =

Distributing Business A
Stock =

Distributing Business B
Stock =

Financial Advisers =

Date A =

Date B =

State C =

a =

This letter responds to your July 2, 2001 request for rulings regarding 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 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 rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Summary of Facts

Publicly traded Distributing is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing conducts Business A and Business B through corporate subsidiaries and limited liability companies (each of the latter, an “LLC”).

Distributing has two classes of voting common stock outstanding, Distributing Business A Stock, and Distributing Business B Stock, which are intended to reflect the performance of Business A and Business B, respectively. Distributing has a single class of preferred stock outstanding (the “Preferred Stock”).

Distributing wholly owns the stock of Sub 1, which is engaged, directly and indirectly, in Business A. Sub 1 owns an a percent interest in LLC 1, which is treated as a partnership for federal income tax purposes under § 301.7701-3 of the Procedure and Administrative Regulations. Distributing wholly owns LLC 2, which is engaged in Business B and which is a disregarded entity and treated as a division of Distributing for federal income tax purposes under § 301.7701-3 of the Procedure and Administrative Regulations.

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 for each of the past five years.

Financial Advisers have advised Distributing that the coexistence of Business A and Business B within the Distributing affiliated group is responsible for substantial management, systemic, and other problems that will be alleviated by the separation of Business B from the Distributing affiliated group. Among the difficulties that Distributing has experienced are (i) competition among business units for limited resources and for business opportunities, (ii) the inappropriateness of its current capital structure, and (iii) the general inability of the management of each of Business A and Business B to focus exclusively on the business needs of its business.

Proposed Transaction

To accomplish the separation of Business B from the Distributing group that will allow Distributing and Controlled to address the business needs and concerns just described, Distributing has partially completed and proposed the following transaction:

(i) On Date A, Distributing and its subsidiaries completed an internal restructuring to better align its assets and liabilities with their respective businesses.

(ii) On Date B, LLC 2 will be converted under State C law (the “LLC 2 Conversion”) into a corporation (“Controlled”). As a result, Distributing will be treated as

contributing all of the assets that constitute Business B to newly formed Controlled in exchange for all of the Controlled stock and the assumption by Controlled of related liabilities (the "Contribution").

(iii) Distributing will distribute all of the Controlled stock to holders of Distributing Business B Stock in exchange for all of the Distributing Business B Stock (the "Distribution"). Distributing will redeem any Distributing Preferred Stock outstanding.

(iv) In connection with the transaction, Distributing, Controlled, and LLC 2 will have entered into a series of intercompany agreements (the "Intercompany Agreements") including a tax sharing agreement.

(v) In connection with the transaction, a portion of Distributing debt will be allocated to Controlled through a combination of new debt issuances and exchange offers for Distributing debt and an assumption of Distributing debt by Controlled in an amount necessary to establish appropriate capital structures for Distributing and Controlled.

Representations

The taxpayer has made the following representations concerning the Contribution and Distribution:

(a) The internal restructuring completed on Date A qualified as a tax-free reorganization under § 368(a)(1)(F).

(b) The fair market value of the Controlled stock received by each Distributing Business B Stock shareholder will approximately equal the fair market value of the Distributing Business B Stock surrendered by the shareholder in exchange therefor.

(c) No part of the consideration distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a Distributing shareholder.

(d) The five years of financial information submitted on behalf of Distributing (regarding Business A) and Controlled (regarding Business B as conducted by Distributing before the Contribution) represents the present operation of each business, and with regard to each business, there have been no substantial operational changes 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 Business A and Business B.

(f) The Distribution is being carried out to alleviate management, systemic, and other problems that arise from (or are exacerbated by) the coexistence of Business A and Business B as separate divisions within the Distributing affiliated group. 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 or security holder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, Distributing or Controlled after the Distribution.

(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 § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

(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.

(j) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing in the Contribution will, in each instance, equal or exceed the liabilities assumed (as determined under § 357(d)) by Controlled.

(k) The liabilities assumed (as determined under § 357(d)) in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred or are being assumed to establish the appropriate liquidity and capital structure for each of Distributing and Controlled.

(l) Except with respect to the assumption of liabilities and in connection with continuing transactions under the Intercompany Agreements, no intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution. Any debt owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

(m) 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 a controlled corporation (Sub 1) which is engaged in the active conduct of a trade or business as defined in § 355(b)(2).

(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 by T.D. 8597). Further, any excess loss account Distributing may have in the Controlled stock or any direct or indirect Controlled subsidiary will be included in income immediately before the Distribution to the extent required by applicable regulations (see § 1.1502-19).

(o) Except for payments under certain post-Distribution agreements, payments made in connection with any continuing transactions 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.

(p) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(q) The Distributing Business A Stock and Distributing Business B Stock each is stock of Distributing for federal income tax purposes.

(r) 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.

(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 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.

(t) 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 Controlled or Distributing entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Controlled or Distributing.

Rulings

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

(1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under § 368(b).

(2) No gain or loss will be recognized by Distributing on the Contribution (§§ 361(a), 357(a), 361(b)(3), and 361(c)(3)).

(3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).

(4) The basis of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the transfer (§ 362(b)).

(5) The holding period of each asset received by Controlled in the Contribution will include the period during which Distributing held that asset (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing on the Distribution (§§ 355(c) and 361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the holders of Distributing Business B Stock on the receipt of Controlled stock in exchange for Distributing Business B Stock (§ 355(a)(1)).

(8) A shareholder who receives Controlled stock in the Distribution will have an aggregate adjusted basis in the Controlled stock immediately after the Distribution equal to the aggregate adjusted basis of the Distributing Business B Stock surrendered in the Distribution (§358(a)(1)).

(9) The holding period of the Controlled stock received by a shareholder in the Distribution will include the holding period of the Distributing Business B Stock surrendered in exchange therefor, provided the Distributing Business B Stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(10) Earnings and profits will be allocated between Distributing and Controlled in accordance with §§ 312(h) and 1.312-10(a).

(11) Any payments made between Distributing, Controlled or their respective subsidiaries under the tax sharing agreement regarding tax liabilities that (i) relate to a taxable period ending on or before the Distribution or to a taxable period beginning before and ending after the Distribution and (ii) do not become fixed and ascertainable until after the Distribution, will be treated as occurring immediately before the Distribution.

Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed on

(i) the internal restructuring described in step (i) above;

(ii) the treatment of non-arm's length payments described in representation (o);
and

(iii) whether the Distributing Business A Stock or Distributing Business B Stock is stock of Distributing for federal income tax purposes;

Procedural Statements

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each taxpayer involved in this transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the transaction covered by this letter is completed.

Under a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely,
Lewis K Brickates
Acting Chief, Branch 4
Office of the Associate Chief Counsel
(Corporate)