

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Refer Reply To:

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Date:

February 25, 2000

Re:

Legend:

Distributing =

Controlled =

Division A =

Division B =

Business A =

Business B =

a =

b =

c =

d =

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Dear _____ :

This responds to your letter dated June 30, 1999, in which you requested rulings on certain federal income tax consequences of a proposed transaction, specifically under Section 355 of the Internal Revenue Code. Additional information regarding your request was submitted in letters dated September 13, 1999; September 29, 1999; October 29, 1999; November 23, 1999; January 31, 2000; and February 8, 2000. The information and representations upon which this ruling letter is based are as follows.

Distributing is a closely held, domestic corporation with d shares of stock held by a shareholders none of whom have acquired such stock in a taxable purchase within the last five years. Distributing is currently engaged in two lines of business which are operated in two divisions: Division A is engaged in Business A and Division B is engaged in Business B. Financial information has been received indicating that Business A and Business B have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years. Controlled will be formed to effectuate the transaction described below. After the transaction Controlled will be engaged in Business B and Distributing will be engaged in Business A.

Distributing proposes to separate Division B in order to satisfy concerns of certain of its customers regarding confidentiality of customer information. Division A and Division B separately provide services for two major customers of Distributing who are directly in competition with each other. In the course of providing such services, the customers provide marketing information and intellectual property to Distributing. The dissemination of such information or intellectual property of either one of Distributing's major customers to either of Distributing's other major customer would severely adversely impact either customer.

These customers, who respectively represent b and c percent of Division A's and Division B's overall revenue, have expressed their objection to the business affiliations inherent in the current organizational structure. Both customers have indicated that they are reluctant to continue doing business under the present structure. Distributing has submitted information indicating that the potential loss of income from losing these customers is significant. To alleviate these customer concerns, Distributing proposes to separate Controlled in the following Spin-Off Transaction:

- (i) Distributing will create a new corporation (Controlled) to which it will transfer the assets and liabilities comprising its Division B business solely in exchange for all of the outstanding Class A common stock of Controlled.
- (ii) Distributing then will distribute all of its Controlled Class A common stock representing 100 percent of the total voting power of all stock entitled to

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vote (approximately d shares) pro-rata to its shareholders. Controlled will also be authorized to issue Class B common stock, but no Class B stock will be distributed in connection with or subsequent to the transaction.

Distributing has made the following additional representations concerning the transaction described above:

- (a) No part of the consideration to be distributed by Distributing will be received by any person as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (b) The five years of financial information submitted on behalf of Division A and Division B represent each division's present operations, and with regard to each Division, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the distribution, Distributing and Controlled each will continue to be engaged in the active conduct of their respective business, independently and with separate employees.
- (d) The distribution of the stock of Controlled is being carried out for the corporate business purpose of resolving problems with customers who object to Distributing being associated with a business that competes with the customers. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (e) There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the transaction.
- (f) 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.
- (g) 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.
- (h) 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 plus any liabilities to which the

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transferred assets are subject.

- (i) The liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (j) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (k) The distribution of stock of Controlled 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 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) No intercorporate debt will exist between Distributing or Controlled at the time of, or subsequent to, the Distribution of Controlled stock.
- (m) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be at fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (n) Neither Distributing nor Controlled is an investment company as defined in Section 368(a)(2)(F)(iii) and (iv).

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

- (1) The transfer by Distributing of the assets and liabilities of Division B to Controlled solely in exchange for all of the Class A common stock of Controlled followed by the pro rata distribution of the Controlled Class A common stock held by Distributing will constitute a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under section 368(b).
- (2) No gain or loss will be recognized by Distributing upon the transfer of assets, subject to liabilities, of Division B to Controlled (Sections 361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled upon the receipt of the Division B assets in exchange for the Class A common stock of Controlled (Section 1032(a)).

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- (4) The basis of the assets to be received by Controlled will equal the basis of such assets in the hands of Distributing immediately prior to the transaction. (Section 362(b)).
- (5) The holding period of the Division B assets to be received by Controlled will include the period during which such assets were held by Distributing (Section 1223(2)).
- (6) No gain or loss will be recognized by Distributing upon the distribution of all of its shares of Controlled Class A common stock to the Distributing shareholders (Section 361(c)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders upon the receipt of the Controlled Class A common stock in the Distribution (Section 355(a)(1)).
- (8) The holding period of the Controlled Class A common stock received by each Distributing shareholder pursuant to the Distribution will include the period during which the Distributing shareholder held the Distributing stock with respect to which the distribution is made, providing such stock is held as a capital asset by the Distributing shareholder on the date of the distribution (Section 1223(1)).
- (9) Each Distributing shareholder's basis in the Distributing stock held before the distribution will be allocated between the Distributing stock and the Controlled Class A common stock held by such shareholder after the distribution in proportion to the relative fair market values of such stock (Section 358(b) and Section 1.358-2 of the Income Tax Regulations).
- (10) As provided in Section 312(h), proper allocations of earnings and profits will be made in accordance with Section 1.312-10(a) of the Income Tax Regulations).

Distributing understands that the National Office of the Internal Revenue Service has, as requested by Distributing, considered and ruled on only the Spin-Off Transaction. Distributing acknowledges that all other transactions leading up to or occurring simultaneously with the Spin-Off Transaction have not been reviewed or ruled on by the National Office of the Internal Revenue Service. Distributing further acknowledges that the consequences of these other related transactions may be examined by the District Director's office on audit of the federal tax returns of Distributing and its affiliates.

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

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

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

Sincerely yours,

Assistant Chief Counsel (Corporate)

By: Debra Carlisle

Debra Carlisle
Chief, Branch 5