

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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Date:

July 26, 2002

### LEGEND

Distributing =

Controlled =

Target =

Merger Sub =

State A =

Business A =

Business B =

Business C =

Operation 1A =

Operation 2A =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Year 1 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

n1 =

n2 =

n3 =

n4 =

n5 =

n6 =

n7 =

p1% =

p2% =

p3% =

p4% =

Dear

We respond to a letter dated March 15, 2002, submitted on your behalf by your authorized representative, requesting rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated June 14, 2002, July 18, 2002, and July 23, 2002. The information submitted for consideration is summarized below.

## SUMMARY OF FACTS

Distributing is a publicly traded State A corporation that was incorporated in Year 1. Distributing is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing engages in Business A (which consists of Operation 1A and Operation 2A), Business B, and Business C directly and indirectly through its wholly owned subsidiaries.

Distributing has one class of stock outstanding: its common stock ("Distributing Common Stock"). As of Date 1, Distributing had n1 shares of Distributing Common Stock issued and outstanding. As of Date 2, Distributing had n2 options to purchase outstanding Distributing Common Stock. Distributing issued the options pursuant to incentive plans ("Distributing Incentive Plans") providing for common stock based awards to employees and non-employee directors. In Date 3, Distributing's Board of Directors authorized the repurchase of up to n3 shares of Distributing Common Stock ("Stock Repurchase Plan"). In connection with its Stock Repurchase Plan, Distributing purchased n4 shares and n5 shares during the fiscal years ending Date 2 and Date 4, respectively. It is anticipated that Distributing may engage in future share repurchases consistent with its past practice.

Distributing conducts Business A through Sub 1, a wholly owned

subsidiary that conducts Operation 1A directly and conducts Operation 2A through several of Sub 1's wholly owned subsidiaries.

Distributing conducts Business B both directly and indirectly through a wholly owned subsidiary, Sub 2.

Distributing conducts Business C both directly and indirectly through three wholly-owned subsidiaries: Sub 3, Sub 4, and Sub 5.

Financial information has been received that indicates that Business A and Business B have each had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past 5 years.

Controlled is a State A corporation, formed on Date 5 to facilitate the Proposed Transaction (defined below). Controlled has one class of stock outstanding, its common stock ("Controlled Common Stock"). Distributing owns 100% of the vote and value of the issued and outstanding Controlled Common Stock. At the date of the Distribution (defined below), there will be issued and outstanding n6 shares of Controlled Common Stock. Controlled will establish a stock incentive plan of its own ("Controlled Stock Incentive Plan"), to be effective not later than the date of the Distribution (defined below). The Controlled Stock Incentive Plan will be substantially similar in terms to the Distributing Incentive Plans as in effect and applicable to Controlled employees as of the date of the Distribution (defined below). In addition, it is anticipated that following the Proposed Transaction (defined below), Controlled will be publicly traded.

Immediately following the Proposed Transaction (defined below), Controlled will be engaged directly and indirectly through wholly-owned subsidiaries in Business B.

Target is a widely held and publicly traded corporation unrelated to Distributing or Controlled. Target engages in Business B. It has one class of stock outstanding, its common stock ("Target Common Stock"). Target also has outstanding options to purchase Target Common Stock awarded under Target's common stock incentive plan.

## PROPOSED TRANSACTION

Distributing wishes to have its Business B acquire unrelated Target, but Target will not agree to the acquisition unless Distributing first separates its Business B operations from its Business A and Business C operations through

the Proposed Transaction (defined below).

Accordingly, the following steps are proposed (collectively, the “Proposed Transaction”):

- (i) As part of a plan of internal restructuring, Distributing will contribute its directly owned Business C property (and transfer associated liabilities) to Sub 3 and Sub 4. Distributing will then contribute to Sub 1: (i) all the stock of Sub 3, Sub 4 and Sub 5, (ii) Distributing’s investment assets, and (iii) intercompany receivable accounts owed to Distributing by its subsidiaries (the intercompany receivables owed to Distributing by Sub 1 will be eliminated upon their contribution to Sub 1).
- (ii) Distributing will transfer all of the property of Business B held by Distributing (including all the stock of Sub 2) subject to liabilities attributable to Business B, to Controlled in exchange for Controlled Common Stock (the “Contribution”);
- (iii) Thereafter, Distributing will distribute all of the outstanding Controlled Common Stock to the holders of record of Distributing Common Stock (the “Shareholders”) on a prorata basis (the “Distribution”). Shareholders will not surrender any shares in Distributing. Shareholders will receive approximately n7 shares of Controlled Common Stock for each outstanding share of Distributing Common Stock. Any fractional shares of Controlled Common Stock will be accumulated by an exchange agent who sells such fractional shares on the open market with the net proceeds going to the respective shareholders in lieu of the fractional shares.
- (iv) In connection with the Distribution, each Distributing Common Stock option granted to an employee of Distributing’s Business B under the Distributing Incentive Plans that is outstanding and unexercised as of the Distribution date will be converted into an option to purchase Controlled Common Stock under the Controlled Incentive Plan. The terms of such converted options will be set so as to preserve the value the holders of such converted options had in their Distributing Common Stock options immediately before the Distribution.
- (v) Immediately following the Distribution and pursuant to an agreement dated Date 6 (the “Merger Agreement”), Merger Sub, a wholly owned subsidiary of Controlled formed solely to facilitate this transaction, will merge with and into Target (the “Merger”). The separate existence of Merger Sub will cease, and Target will continue as the surviving corporation of the Merger. As part of the Merger, each share of Target Common Stock issued and outstanding immediately prior to the Merger

will be exchanged for one share of Controlled Common Stock. As a result of the Merger, Controlled will own 100% of the Target Common Stock, and the former Target shareholders will own approximately between p1% and p2% of Controlled Common Stock.

- (vi) In connection with the Merger, each Target Common Stock option awarded under Target's common stock incentive plan that is outstanding and unexercised as of the Merger date will be converted into an option to purchase Controlled Common Stock under the Controlled Incentive Plan. The terms of such converted options will be set so as to preserve the value the holders of such converted options had in their outstanding Target Common Stock options immediately before the Merger.

The Proposed Transaction will result in Distributing shareholders owning approximately between p3% and p4% of Controlled immediately after the Merger.

In connection with the Proposed Transaction, Distributing and Controlled will enter a tax sharing agreement ("Tax Sharing Agreement") that will set forth each party's rights and obligations with respect to tax matters for periods before and after the date of the Distribution. The Tax Sharing Agreement will detail Distributing's and Controlled's responsibilities relating to tax payments and refunds, the filing of returns, and the conduct of audits. The Tax Sharing Agreement will also provide for cooperation with respect to certain tax matters and for the exchange of information and retention of records that may affect the tax liability of either party. Certain payments might be made between Distributing, Controlled or their respective subsidiaries pursuant to the Tax Sharing Agreement after the Distribution.

Also in connection with the Proposed Transaction, Distributing and Controlled will enter into (i) a Transition Services Agreement which will set forth the transitional relationships between Distributing and Controlled during a limited transition period following the Distribution, including the provision by Distributing of certain corporate services to Controlled and the temporary sharing of physical facilities by Distributing and Controlled; and (ii) an indemnification agreement whereby Distributing and Controlled have agreed to indemnify each other against potential liabilities arising from certain securities law, tax, and other matters relating to the respective businesses of Distributing and Controlled (the "Indemnification Payments").

## REPRESENTATIONS

The following representations have been made in connection with the proposed

transaction:

- (a) Any indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (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 Distributing.
- (c) The 5 years of financial information submitted on behalf of Business A is representative of its present operation, and with regard thereto, there have been no substantial operational changes since the date of the last financial statement submitted.
- (d) The 5 years of financial information submitted on behalf of Business B is representative of its present operation, and with regard thereto, there have been no substantial operational changes since the date of the last financial statement submitted.
- (e) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees,
- (f) The Distribution will be carried out to facilitate the acquisition of Target by Controlled pursuant to the Merger Agreement. The Distribution is motivated, in whole or substantial part, by this and other corporate business purposes.
- (g) Before the first anniversary of the Distribution, Merger Sub will merge with and into Target pursuant to the Merger Agreement.
- (h) There is no plan or intention by any shareholder who is the legal or beneficial owner of 5 percent or more of the stock of Distributing, and 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 Distribution.
- (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 §4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696 or in connection with Distributing's stock repurchase plan.

- (j) There is no plan or intention to liquidate Distributing or Controlled, to merge either corporation with any corporation, or to sell or otherwise dispose of the assets of either of the corporations after the transaction, except for (i) dispositions in the ordinary course of business or (ii) the Merger of Controlled and Target pursuant to the Merger Agreement.
- (k) The total adjusted basis 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 transferred assets are subject.
- (l) 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.
- (m) The income tax liability for the taxable year in which any 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.
- (n) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (o) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution of the stock of Controlled, except for debt that is incurred by Controlled for working capital purposes from the time of its formation until the Distribution and Merger, which will be settled as part of the net working capital adjustment shortly after the Merger, and any indebtedness incurred in the ordinary course or for obligations resulting from agreements for shared services or facilities or pursuant to any indemnification payments.
- (p) 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. Further, any excess loss account Distributing may have in Controlled stock will be included in income immediately before the Distribution to the extent required by the applicable regulations.
- (q) 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.



- (r) No two parties to the transaction are investment companies as defined in Section §368(a)(2)(F)(iii) and (iv) .
- (s) The payment of cash in lieu of fractional shares of Controlled will be solely for the purpose of avoiding the expense and inconvenience to Controlled of issuing fractional shares and does not represent separately bargained for consideration. The total cash consideration that will be paid in the transaction to the Distributing shareholders will not exceed one percent of the consideration that will be distributed in the proposed transaction. The fractional share interests in Controlled of Distributing record shareholders will be aggregated, and no such shareholder will receive cash in an amount equal to or greater than the value of one full share of Controlled stock.
- (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 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 distribution date.  
  
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 distribution date, 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 distribution date.
- (u) The distribution is not part of a plan or series of related transaction 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 Distributing or Controlled stock entitled to vote or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.
- (v) 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 Sub 1, which is engaged in the active conduct of a trade or

business as defined in §355(b)(2).

- (w) Immediately after the Distribution, the gross assets of the business conducted directly by Sub 1 (i.e. Operation 1A) will have a fair market value of at least 5 percent of the total fair market value of the gross assets of Sub 1.
- (x) Immediately after the Distribution, the gross assets of Controlled's Business B will have a fair market value of at least 5 percent of the total fair market value of the gross assets of Controlled.

## RULINGS

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

- (1) The transfer by Distributing to Controlled of the property, subject to liabilities, of Business B in exchange for the issuance to Distributing of Controlled Common Stock and Controlled's assumption of liabilities, followed by the distribution by Distributing of all of its Controlled Common Stock to the Shareholders, will qualify as 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) No gain or loss will be recognized by Distributing on its transfer of the property of Business B to Controlled in exchange for Controlled Common Stock. (§§361(a), (b)(1)(A), (b)(3), and 357(a)).
- (3) No income, gain or loss will be recognized by Controlled on the Contribution. (§1032(a)).
- (4) The basis of the property received by Controlled will be the same as the basis of such property in the hands of Distributing immediately prior to the Contribution. (§362(b)).
- (5) The holding period of the property received by Controlled will include the period during which such property was held by Distributing. (§1223(2)).
- (6) No income, gain or loss will be recognized by the Shareholders upon their receipt of the Controlled Common Stock pursuant to the Distribution. (§355(a)(1)).
- (7) No income, gain or loss will be recognized by Distributing upon the

distribution to the Shareholders of its stock of Controlled pursuant to the Distribution. (§361(c)).

- (8) The aggregate basis of the Distributing Common Stock and the Controlled Common Stock in the hands of the Shareholders will be the same as the basis in the Distributing Common Stock held by the Shareholders immediately before the Distribution, allocated in proportion to the respective fair market values of the Distributing Common Stock and the Controlled Common Stock in accordance with Treas. Reg. §1.358-2(a)(2). (§358(a)(1) and (b)).
- (9) The holding period of the Controlled Common Stock received by the Shareholders will, in each instance, include the holding period of the Distributing Common Stock with respect to which the distribution of the Controlled Common Stock is made, provided that such Distributing Common Stock is held as a capital asset on the date of the Distribution. (§1223(1)).
- (10) As provided in §312(h), proper allocation of earnings and profits will be made between Distributing and Controlled in accordance with Treas. Reg. §1.312-10(a).
- (11) The payment of cash, if any, in lieu of fractional shares of Controlled Common Stock will be treated for federal income tax purposes as if the fractional shares had been distributed as part of the Distribution and then had been sold by the holders. Accordingly, a shareholder will recognize gain or loss, if any, equal to the difference between the cash received and the basis of the fractional share as determined under §1001. If Controlled Common Stock is held by the exchanging shareholder as a capital asset, the gain or loss will be subject to the provisions and limitations of Subchapter P of Chapter 1 of the Internal Revenue Code. (§§1221 and 1222).
- (12) Payments made by Distributing to Controlled or by Controlled to Distributing under the Tax Sharing Agreement regarding tax liabilities that (i) have arisen or will arise for a taxable period ending on or before the Distribution or for a taxable period beginning on or before and ending after the Distribution, and (ii) will not become fixed and ascertainable until after the Distribution, will be treated as occurring immediately before the Distribution. See Arrowsmith v. Commissioner, 344 U.S. 6 (1952).

#### CAVEAT

No opinion is expressed about the tax treatment of the proposed

transaction under other provisions of the Code and regulations or about 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.

#### PROCEDURAL STATEMENTS

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. §6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to the federal income tax return of each taxpayer involved in the taxable year in which the transaction is consummated.

Pursuant to a power of attorney on file in this office, we have sent copies of this letter to your authorized representatives.

Sincerely yours,

Alfred C. Bishop, Jr.  
Alfred C. Bishop, Jr.  
Chief, Branch 6  
Office of Associate Chief Counsel  
(Corporate)

cc: