

Internal Revenue Service

Number: **200615007**

Release Date: 4/14/2006

Index Number: 83.07-00, 1032.00-00,
402.07-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:TEGE:EB:EC

PLR-129256-05

Date:

January 10, 2006

Legend

Distributing =

Controlled =

Plan X =

Date A =

Date B =

Date C =

Dear :

This letter responds to your representative's letter dated May 26, 2005, requesting rulings as to certain federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated August 10, August 19, August 24, and November 21, 2005.

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.

Distributing is the parent corporation of its wholly-owned subsidiary, Controlled. Distributing's operations consist of several different businesses conducted through its wholly owned subsidiaries, one of which is conducted by Controlled. Distributing has determined that the best way to resolve systemic issues related to the allocation of capital and management resources between a business conducted by one of its subsidiaries and the business conducted by Controlled is to spin off Controlled to Distributing's shareholders. Accordingly, all of the common stock of Controlled will be distributed to the holders of Distributing stock in a pro rata spin-off (Distribution). In a private letter ruling issued on Date A, the Office of Associate Chief Counsel (Corporate) ruled (subject to certain caveats) that the Distribution will qualify for nonrecognition of gain or loss to the shareholders of Distributing under § 355(a)(1) of the Internal Revenue Code. In that same letter, the Office of Associate Chief Counsel (Corporate) also ruled (subject to certain caveats) that the aggregate basis of the Distributing common stock and the Controlled common stock (including any fractional interest in the Controlled common stock) in the hands of shareholders of Distributing common stock immediately after the Distribution will be the same as the aggregate basis of the Distributing common stock held by such shareholders immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with section 1.358-2(a)(2) of the Income Tax Regulations (regulations).

Following the Distribution, Distributing and Controlled will no longer be part of the same controlled group of corporations within the meaning of section 414(b), (c), (m) or (o).

Before the Distribution, Distributing issued to certain employees and directors of Distributing and its subsidiaries nonqualified options to purchase Distributing stock with an exercise price equal to the fair market value of Distributing stock on the date of grant. The options did not have a readily ascertainable fair market value under § 83. They vest ratably at one-fourth or one-third per year beginning with the first or second anniversary of the grant date. Also, before the Distribution, Distributing issued to certain employees and directors of Distributing and its subsidiaries shares of restricted stock in Distributing that are non-transferable and subject to a substantial risk of forfeiture before vesting (Distributing Restricted Stock). Distributing Restricted Stock generally vests ratably at 25 percent per year beginning with the first anniversary of the grant date or, in some cases, 100 percent four years from the grant date. The vesting of certain Distributing Restricted Stock is conditioned on certain performance objectives. In addition, holders of Distributing Restricted Stock are afforded certain rights of ordinary shareholders of Distributing stock, including the right to vote the shares of Distributing Restricted Stock and the right to receive quarterly dividend-equivalent payments with respect to such shares.

Options in Distributing stock held by employees who will be Controlled employees after the Distribution (Controlled Employees) will be treated differently depending on whether

the options are vested on the distribution date. Vested Distributing options held by Controlled Employees will remain options on Distributing shares. Their exercise price and number of shares subject to each option will be adjusted so that (a) the excess of the aggregate fair market value of the Distributing shares subject to the options immediately after the Distribution over the aggregate option prices of those shares will be equal to the corresponding excess immediately before the Distribution, and (b) on a share-by-share comparison, the ratio of the option price to the fair market value of the Distributing shares subject to the options immediately after the Distribution will equal the corresponding ratio immediately before the Distribution. (These options so adjusted are the Adjusted Distributing Options.) For purposes of determining whether an option is an Adjusted Distributing Option, options that would have vested before Date B if the employee had retired (assuming the Distribution had not occurred) will be counted as vested. Unvested Distributing options held by Controlled Employees will be converted to Controlled options, which will be adjusted to preserve their appreciation element similar to the way Distributing options will be adjusted.

Controlled Employees will not receive options on both Distributing and Controlled stock.

In lieu of the distribution of shares of Controlled stock that all other Distributing shareholders will receive pursuant to the Distribution, the shares of Distributing Restricted Stock held by persons who, following the Distribution, will be employees or directors of Distributing (Remaining Individuals) will be adjusted (the Adjusted Distributing Restricted Stock) to reflect the Distribution in a manner so that the fair market value of the Distributing Restricted Stock immediately before the Distribution is equal to the fair market value of the Adjusted Distributing Restricted Stock immediately after the Distribution. Adjusted Distributing Restricted Stock will be subject to the same restrictions as Distributing Restricted Stock.

In lieu of the distribution of shares of Controlled stock that all other Distributing shareholders will receive pursuant to the Distribution, the shares of Distributing Restricted Stock held by Controlled Employees will be adjusted by increasing the number of shares of Distributing Restricting Stock to reflect the Distribution (Adjusted Distributing Restricted Stock) in the manner discussed with respect to Adjusted Distributing Restricted Stock held by Remaining Individuals. Shares of Adjusted Distributing Restricted Stock held by Controlled Employees that would vest, assuming the Distribution did not occur, before Date B, will remain shares of Adjusted Distributing Stock.

All other shares of Adjusted Distributing Restricted Stock held by Controlled Employees will then be substituted with restricted shares of Controlled stock (Controlled Restricted Stock) of equal fair market value. Controlled Restricted Stock will be subject to the same terms, conditions and restrictions as the original Distributing Restricted Stock; provided, that in the case of any Controlled Restricted Stock that vests based on performance, the underlying performance criteria may be adjusted to reflect the Distribution.

Distributing maintains Plan X for the benefit of its employees. Plan X is a defined contribution plan intended to qualify under Code section 401(a). Plan X offers its participants various investment alternatives, one of which is the Plan X Stock Fund. Effective as of Date C, the Plan X Stock Fund was structured to qualify as an employee stock ownership plan (ESOP) as described in Code section 4975(e)(7).

Pursuant to the Distribution described above, the Plan X Stock Fund will receive a proportionate share of Controlled stock based on its ownership of Distributing stock. Effective as of the Distribution, Controlled expects to adopt a plan (Controlled Plan) that is intended to be qualified under Code section 401(a) and that will generally mirror Plan X. Controlled Plan will offer similar investment options, except that the Controlled Plan Stock Fund will invest primarily in shares of Controlled stock. The Controlled Plan Stock Fund is intended to qualify as an ESOP as described in Code section 4975(e)(7).

The Plan X account balances of all Controlled employees will be transferred to Controlled Plan. A new fund will be established in Plan X to hold Controlled shares received by the Plan X Stock Fund in connection with the Distribution. A new fund will also be established in Controlled Plan to hold shares of Distributing stock that will be received in the transfer of the existing account balances of Controlled employees.

Plan X may, at the direction of the applicable Plan X fiduciary or Plan X participants, exchange Controlled shares held by Plan X for Distributing shares or may dispose of such Controlled shares and reinvest the proceeds of such disposition in Distributing shares. Similarly, Controlled Plan may, at the direction of the applicable Controlled Plan fiduciary or Controlled Plan participants, exchange Distributing shares held by Controlled Plan for Controlled shares or may dispose of such Distributing shares and reinvest the proceeds of such disposition in Controlled shares.

Restricted Stock and Options

Under § 1.83-1(b)(1) of the regulations, if substantially nonvested property is subsequently sold or otherwise disposed of in an arm's length transaction while still substantially nonvested, the person who performed the services in connection with which such nonvested property was transferred shall realize compensation in an amount specified in the regulations. Under § 1.83-1(b)(3), § 1.83-1(b)(1) shall not apply to, and no gain shall be recognized on, any such sale or other disposition to the extent that any property received in exchange therefor is substantially nonvested. Instead, section 83 and § 1.83-1 shall apply with respect to such property received (as if it were substituted for the property disposed of).

Section 1032(a) provides, in part, that no gain or loss is recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation. Under § 1.1032-1(a), a transfer by a corporation of its own stock as compensation for services is considered a disposition for money or other property.

Therefore, when a corporation compensates its employees with its own stock, the corporation does not recognize gain or loss under § 1032.

Under § 1.1032-3, in certain transactions where an acquiring corporation acquires money or other property in exchange for stock of a corporation (the issuing corporation), the acquiring corporation is treated as purchasing the stock of the issuing corporation from the issuing corporation for fair market value with cash contributed to the acquiring corporation by the issuing corporation. Section 1.1032-3 generally enables a corporate subsidiary to obtain a fair market value basis in parent stock contributed to the subsidiary's capital if the subsidiary disposes of the parent stock in a taxable transaction immediately after it is received from the parent. As a result of the operation of § 1.1032-3, a subsidiary generally does not recognize gain or loss on the immediate transfer of parent stock to the subsidiary's employee.

In Rev. Rul. 2002-1, 2002-1 C.B. 268, D corporation in Year 1 issued to B, an employee of D's subsidiary C, options to buy D stock. In Year 3, D distributed the stock of C to its shareholders in a spin-off transaction qualifying under § 355. At the time of the spin-off, the D options held by B were replaced with options to buy stock in D from D and stock in C from C (the post-division options). In Year 6, B exercises the post-division options. The total exercise price of the post-division options was equal to the exercise price of the pre-division options. Rev. Rul. 2002-1 holds that the characterization of B's exercise of the post-division options of D should reflect the parent-subsidiary relationship of D and C that existed in Year 1, when the options were granted to B. The ruling in essence applies § 1.1032-3 as if C is still a subsidiary of D, holding that C recognizes no gain or loss when stock options for D stock held by B that are received in connection with the spin-off are exercised. Therefore, under the rationale of Rev. Rul. 2002-1, it is appropriate to apply § 1.1032-3 so that Controlled will not have gain or loss recognition.

Based solely on the information submitted, we rule as follows:

- (1) Assuming that no election under section 83(b) has been made, the adjustment of Distributing Restricted Stock into Adjusted Distributing Restricted Stock with respect to Remaining Individuals will not result in income, gain, or loss to the Remaining Individuals.
- (2) Assuming that no election under section 83(b) has been made, the substitution of Distributing Restricted Stock with Controlled Restricted Stock with respect to Controlled Employees will not result in income, gain, or loss to the Controlled Employees.
- (3) Controlled will recognize no income, gain, or loss when the Adjusted Distributing Options held by Controlled Employees that are received in connection with the Distribution are exercised after the Distribution.

Plan X and Controlled Plan

Based on the foregoing facts and representations, your authorized representatives have requested the following rulings:

- (a) The shares of Controlled acquired by Plan X as a result of the Distribution will be treated as “securities of the employer corporation” for purposes of excluding net unrealized appreciation from income under Code section 402(e);
- (b) Distributing shares held by Controlled Plan will be treated as “securities of the employer corporation” for purposes of excluding net unrealized appreciation from income under Code section 402(e);
- (c) For purposes of determining net unrealized appreciation under Code section 402(e), the basis of Distributing shares and Controlled shares held by Plan X immediately after the Distribution will be determined by allocating the basis of the Distributing shares held by Plan X for the benefit of Plan X participants immediately before the Distribution between the Distributing shares and the Controlled shares in proportion to their relative fair market values, in accordance with the rules of Code section 358;
- (d) For purposes of determining net unrealized appreciation under Code section 402(e), the basis of the Distributing shares and Controlled shares held by Controlled Plan for the benefit of Controlled Plan participants immediately after the Distribution will be determined by allocating the basis of the Distributing shares held by Plan X immediately before the Distribution between the Distributing shares and the Controlled shares in proportion to their relative fair market values, in accordance with the rules of Code section 358;
- (e) In the event that Plan X (i) exchanges Controlled shares received pursuant to the Distribution for Distributing shares or (ii) disposes of such Controlled shares and reinvests the proceeds in Distributing shares within 90 days (or such longer period as the Secretary may prescribe), such exchange or disposition will constitute an exchange of “securities of the employer corporation” for purposes of Code section 402(j)(2) so that the determination of net unrealized appreciation shall be made without regard to such exchange or disposition;
- (f) To the extent that Plan X exchanges Controlled shares for Distributing shares or disposes of Controlled shares and reinvests the proceeds in Distributing shares as described in (e), above, the basis of the replacement Distributing shares for purposes of determining net unrealized appreciation under Code section 402(e) will be equal to the basis of the Controlled shares;
- (g) In the event that Controlled Plan (i) exchanges Distributing shares held by Controlled Plan for Controlled shares or (ii) disposes of such Distributing shares and reinvests the proceeds in Controlled shares within 90 days (or such longer period as the

Secretary may prescribe), such exchange or disposition will constitute an exchange of "securities of the employer corporation" for purposes of Code section 402(j)(2) so that the determination of net unrealized appreciation shall be made without regard to such exchange or disposition; and

(h) To the extent that Controlled Plan exchanges Distributing shares for Controlled shares or disposes of Distributing shares and reinvests the proceeds in Controlled shares as described in (g), above, the basis of the replacement Controlled shares for purposes of determining net unrealized appreciation under Code section 402(e) will be equal to the basis of the Distributing shares.

With respect to requested rulings (a), (b), (c), and (d), section 402(e)(4)(B) of the Code provides, that in the case of a lump sum distribution that includes securities of the employer corporation, unless a taxpayer elects otherwise, there shall not be included in gross income the net unrealized appreciation attributable to that part of the distribution that consists of securities of the employer corporation.

Section 402(e)(4)(E) of the Code provides generally that the term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in subsections (e) and (f) of section 424) of the employer corporation. Section 1.402(a)-1(b)(2)(i) of the regulations provides that the amount of net unrealized appreciation in securities of the employer corporation that are distributed by the trust is the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust. Section 1.402(a)-1(b)(2)(ii) of the regulations sets forth the manner in which the cost or other basis to the trust of a distributed security of the employer corporation is calculated for the purpose of determining the net unrealized appreciation on such security.

In Revenue Ruling 73-29, 1973-1 C.B. 198, securities of an employer corporation held by its qualified plan were transferred to the qualified trust of an unrelated corporation when the first employer sold part of its business and transferred some of its employees to an unrelated corporation. It was held that shares of stock of the seller corporation distributed from the buyer's qualified trust to employees of the buyer corporation who are former employees of the seller corporation are securities of the employer corporation and will always be securities of the employer corporation even after those shares and the employees in whose accounts they were held were transferred to an unrelated corporation.

In the present case, Controlled is a wholly-owned subsidiary of Distributing before the Distribution. Therefore, before the Distribution, Controlled stock constitutes securities of the employer corporation within the meaning of section 402(e)(4)(E) of the Code. Pursuant to and simultaneously with the Distribution, Controlled will cease to be a subsidiary of Distributing. In addition, the Controlled stock distributed to Plan X and to Controlled Plan pursuant to the Distribution will represent part of the pre-Distribution value of the Distributing stock.

Accordingly, with respect to requested ruling (a), we conclude that the shares of Controlled acquired by Plan X as a result of the Distribution will be treated as “securities of the employer corporation” for purposes of excluding net unrealized appreciation from income under section 402(e) of the Code.

With respect to requested ruling (b), Controlled Plan will hold Distributing stock after the Distribution and will acquire Controlled shares as a result of the Distribution. These Distributing and Controlled shares will represent the value of the Distributing shares held by Controlled Plan immediately before the Distribution. Although Distributing and Controlled will no longer be members of the same controlled group of corporations as a result of the Distribution, in accordance with Rev. Rul. 73-29, the Distributing shares will continue to be considered securities of the employer corporation for purposes of Code section 402(e).

Accordingly, with respect to requested ruling (b), we conclude that Distributing shares held by Controlled Plan will be treated as “securities of the employer corporation” for purposes of excluding net unrealized appreciation from income under Code section 402(e).

With respect to requested rulings (c) and (d), Distributing has received a private letter ruling (subject to certain caveats) that the Distribution will qualify for nonrecognition of gain or loss to the shareholders of Distributing under § 355(a)(1) and that the aggregate basis of the Distributing common stock and the Controlled common stock (including any fractional interest in the Controlled common stock) in the hands of shareholders of Distributing common stock immediately after the Distribution will be the same as the aggregate basis of the Distributing common stock held by such shareholders immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with section 1.358-2(a)(2) of the regulations. Section 1.358-2(a)(2) of the regulations provides that if, as a result of a transaction under section 355, a shareholder who owned stock of only one class before the transaction owns stock of two or more classes after the transaction, then the basis of all the stock held before the transaction is allocated among the stock of all classes held immediately after the transaction in proportion to the fair market values of the stock of each class.

Accordingly, with respect to requested ruling (c), we conclude that, for purposes of determining net unrealized appreciation under Code section 402(e), the basis of Distributing shares and Controlled shares held by Plan X immediately after the Distribution will be determined by allocating the basis of the Distributing shares held by Plan X for the benefit of Plan X participants immediately before the Distribution between the Distributing shares and the Controlled shares in proportion to their relative fair market values, in accordance with the rules of Code section 358.

We further conclude with respect to requested ruling (d) that, for purposes of determining net unrealized appreciation under Code section 402(e), the basis of the

Distributing shares and Controlled shares held by Controlled Plan for the benefit of Controlled Plan participants immediately after the Distribution will be determined by allocating the basis of the Distributing shares held by Plan X immediately before the Distribution between the Distributing shares and the Controlled shares in proportion to their relative fair market values, in accordance with the rules of Code section 358.

With respect to requested rulings (e), (f), (g), and (h), Code section 402(j) provides, in pertinent part, that for purposes of section 402(e)(4), in the case of any transaction in which either (A) the plan trustee exchanges the plan's securities of the employer corporation for other such securities, or (B) the plan trustee disposes of securities of the employer corporation and uses the proceeds of such disposition to acquire securities of the employer corporation within 90 days (or such longer period as the Secretary may prescribe), the determination of net unrealized appreciation shall be made without regard to such transaction.

In the present case, we have already indicated that Controlled shares received by Plan X and Distributing shares received by Controlled Plan as a result of the Distribution are securities of the employer corporation, as defined in Code section 402(e)(4)(E), for purposes of section 402. Thus, Plan X's exchange of its Controlled shares for Distributing shares, and Controlled Plan's exchange of its Distributing shares for Controlled shares, would be an exchange of securities of the employer corporation. Additionally, the disposition by Plan X of Controlled shares and the disposition by Controlled Plan of Distributing shares, followed by the reinvestment of the proceeds in Distributing stock for Plan X and in Controlled stock for Controlled Plan, would be a disposition of securities of the employer corporation followed by a reinvestment of the proceeds in securities of the employer corporation.

Accordingly, with respect to requested ruling (e), we conclude that, in the event that Plan X (i) exchanges Controlled shares received pursuant to the Distribution for Distributing shares or (ii) disposes of such Controlled shares and reinvests the proceeds in Distributing shares within 90 days (or such longer period as the Secretary may prescribe), such exchange or disposition will constitute an exchange of "securities of the employer corporation" for purposes of Code section 402(j)(2) so that the determination of net unrealized appreciation shall be made without regard to such exchange or disposition.

With respect to requested ruling (f), we conclude that, to the extent that Plan X exchanges Controlled shares for Distributing shares or disposes of Controlled shares and reinvests the proceeds in Distributing shares as described in (e), above, the basis of the replacement Distributing shares for purposes of determining net unrealized appreciation under Code section 402(e) will be equal to the basis of the Controlled shares.

With respect to requested ruling (g), we conclude that, in the event that Controlled Plan (i) exchanges Distributing shares held by Controlled Plan for Controlled shares or (ii)

disposes of such Distributing shares and reinvests the proceeds in Controlled shares within 90 days (or such longer period as the Secretary may prescribe), such exchange or disposition will constitute an exchange of "securities of the employer corporation" for purposes of Code section 402(j)(2) so that the determination of net unrealized appreciation shall be made without regard to such exchange or disposition.

With respect to requested ruling (h), we conclude that, to the extent that Controlled Plan exchanges Distributing shares for Controlled shares or disposes of Distributing shares and reinvests the proceeds in Controlled shares as described in (g), above, the basis of the replacement Controlled shares for purposes of determining net unrealized appreciation under Code section 402(e) will be equal to the basis of the Distributing shares.

This ruling letter is based on the assumption that Plan X is, and Controlled Plan will be, qualified under Code section 401(a) and that their related trusts are tax exempt under section 501(a) at all relevant times.

This ruling letter is also based on the assumption that the Plan X Stock Fund and the Controlled Plan Stock Fund meet the requirements of Code section 4975(e)(7) at all relevant times.

No opinion is expressed or implied concerning the tax consequences of the proposed transactions 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 proposed transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed concerning the application of section 409A of the Code to the proposed transactions.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Robert B. Misner
Senior Technician Reviewer, Executive
Compensation Branch
Office of Division Counsel/Associate Chief
Counsel
(Tax Exempt & Government Entities)

Enclosure:

Copy of letter for section 6110 purposes