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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:CORP:1-PLR-105061-00

Date:

October 11, 2000

Re:

Distributing =

Controlled =

Target =

Target LLC =

Date A =

Date B =

Business C =

Business D =

Chairman E =

Mutual Fund =

Date F =

G =

J =

K =

L =

M =

N =

P =

Q =

Violation R =

Plan 1 =

Plan 2 =

Plan 3 =

Plan 4 =

Plan 5 =

Plan 6 =

Plan 7 =

State X =

State Y =

Dear

This is in reply to a letter from your authorized representatives, dated March 2, 2000, requesting rulings on a proposed transaction. Additional information was submitted in letters dated May 15, June 5, July 12, July 28, August 1, and August 14, 2000. The information submitted for consideration is summarized below.

Distributing, a publicly traded State X corporation, is the common parent of a group of corporations filing a consolidated federal income tax return. Distributing conducts Business C and Business D.

Target is a State Y corporation engaged in Business D. On Date F, Distributing, in form, acquired all of the stock of Target in exchange for common stock of Distributing and options and warrants to purchase Distributing common stock. The Distributing stock, options and warrants issued to Target shareholders in the transaction represent G percent (which is less than 5 percent) of the stock of Distributing.

Distributing's outstanding stock consists solely of voting common stock. On Date A, Distributing effected an L-for-one split of its common stock. Collectively, the funds operated by Mutual Fund own more than 5 percent of the stock of Distributing. Distributing has represented that no single fund operated by Mutual Fund, or group of funds managed by the same individual or with the same investment objective, owns 5 percent or more of the stock of Distributing. To the best knowledge of Distributing, there are no other shareholders who own 5 percent or more of the stock of Distributing.

Controlled will be formed in State X to effectuate the proposed transaction. Controlled will be engaged in Business C. At the time of the proposed transaction, Controlled will have one class of voting common stock outstanding, all of which will initially be held by Distributing.

Financial information has been received which indicates that Distributing's Business C and Business D have each had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Distributing believes that separating Business C from Business D will enhance the success of each business. Distributing has submitted evidence showing that separating Business C and Business D will resolve current operating problems, including existing and threatened Violation R lawsuits filed by competitors and suppliers of Distributing's Business C products, arising out of Distributing's conduct of both Business C and Business D.

Accordingly, Distributing proposes the following transaction:

(i) Distributing will form Target LLC, a limited liability company. Target will merge with and into Target LLC pursuant to state law. In the merger, Target LLC will acquire all of the assets of Target, subject to Target liabilities.

(ii) Distributing will transfer the assets of Business C to Controlled. Distributing will transfer a portion of its intangible property portfolio to

Controlled. Distributing will transfer a non-compete agreement to Controlled in exchange for a royalty-free cross license to the transferred intangible property and ownership of certain intangible property that Controlled will develop in the future. Distributing represents that this licensing agreement was negotiated on an arm's length basis and the terms and conditions are consistent with similar licenses Distributing has negotiated with third parties. Target LLC will transfer certain Target assets, representing approximately 50 percent of the Target assets, to Controlled.

(iii) Controlled will issue approximately J percent of its stock in an initial public offering (the "IPO"). Controlled will distribute approximately \$K to Distributing. Distributing will use the proceeds distributed by Controlled to repay Distributing's creditors.

(iv) Distributing will distribute all of its Controlled stock, which will constitute at least 80 percent of Controlled's outstanding single class of stock, to its shareholders in a pro rata Distribution (the "Distribution"). Distributing will not distribute fractional Controlled shares in the transaction. Distributing's exchange agent will sell fractional shares in the public market and distribute the cash proceeds to their appropriate beneficial shareholders of record in lieu of fractional shares of Controlled stock. It is not intended that any Distributing shareholder will receive cash in an amount equal to or greater than the value of one full share of Controlled stock on account of Distributing shares of record.

(v) After the Distribution, Distributing will provide administrative services to Controlled. In addition, after the Distribution, Distributing's current chairman, Chairman E, will be the chairman of Distributing and Controlled. Because of his importance to Business C and Business D, the management of Distributing believes that Chairman E's departure from either business would negatively affect shareholder value. Distributing's chief financial officer (CFO) may be CFO of Controlled on a transitional basis. Controlled is actively seeking a CFO and hopes to find one before the Distribution.

(vi) Controlled will adopt stock option and retirement plans for its employees. Certain employees of Distributing will become employees of Controlled. It is expected that Controlled will grant options for Controlled stock to selected employees, consultants, and directors of Controlled and its subsidiaries and will grant Controlled options that will supplement certain outstanding Distributing options. It is also expected that Controlled will establish Plan 7, which is intended to be an "employee stock purchase plan," under which options will be granted to employees of Controlled and

its subsidiaries in substitution for options that were granted to them under Plan 3. As of Date B, employees, former employees and non-employee directors of Distributing held options to purchase an aggregate of M pre-split shares of Distributing common stock.

Plan 1 was established to compensate employees, directors, and consultants of Distributing and its subsidiaries. Under Plan 1, up to N pre-split shares could be purchased through the exercise of “incentive stock options” (“ISOs”) or nonstatutory options. However, no ISOs are outstanding under the plan and none will be granted prior to the Distribution. Options granted under Plan 1 are nontransferable (except upon death) and are always granted with an exercise price that is at least 100 percent of the fair market value of Distributing stock on the date of grant.

Under Plan 1, a committee of two or more “outside directors” may grant options to “covered employees,” as defined in § 162(m) of the Internal Revenue Code. Plan 1 provides that, if there is an event such as the Distribution, Distributing’s board of directors (“the Board”) will appropriately adjust the number of shares reserved for options, the number of shares subject to options, and the exercise price of options granted under the plan.

Under Plan 2, up to P pre-split shares may be purchased through nonstatutory options. Plan 2 was established to compensate Distributing’s directors who are not also employees or consultants of Distributing or its subsidiaries at the time of grant. Options granted under Plan 2 are nontransferable (except upon death) and are always granted with an exercise price that is at least 100 percent of the fair market value of Distributing stock on the date of grant. Plan 2 provides that, if there is an event such as the Distribution, the Board will appropriately adjust the number of shares reserved for options, the number of shares subject to options, and the exercise price of options granted under the plan. Hereafter, Plan 1 and Plan 2 will be referred to collectively as “the Nonstatutory Option Plans.”

It is represented that Plan 3 is an “employee stock purchase plan” as defined in § 423(b) of the Code. Up to Q pre-split shares may be purchased under the plan. Only employees of Distributing or its designated subsidiaries may participate in the plan (within the limits set by § 423). Offering periods run no more than 27 months from the date of grant of options (“ESPP Options”). Participants may set aside, through payroll deductions, up to 15 percent of their earnings during the offering period towards the purchase of shares. ESPP Options have an exercise price that is at least the lesser of (i) 85 percent of the fair market value of Distributing stock on the date of grant or (ii) 85 percent of the fair market value of Distributing stock on the date of exercise. Plan 3 provides that, if there is an event such as the Distribution, the Board will appropriately

adjust the number of shares reserved for options, the number of shares subject to options, and the exercise price of options granted under the plan. Upon termination of employment, ESPP Options terminate immediately.

Under Plan 4, employees of Distributing or its subsidiaries may elect to defer compensation. The election must be made prior to the year in which the compensation would otherwise be paid or prior to the first day of the month after being selected for the plan. Deferrals are held in a trust which, in the event of Distributing's insolvency, is first subject to the claim's of Distributing's creditors. Upon termination of employment, deferrals and the income thereon are distributed (less required tax withholdings). It is represented that, for all purposes of the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 ("ERISA"), Plan 4 is an unfunded and unsecured arrangement for the benefit of select members of management or highly-compensated employees.

Under Plan 5, Distributing deposits its shares to a trust, either as discretionary contributions or as matching contributions based on the size of deferrals made under Plan 4. In the event of Distributing's insolvency, shares held in the trust are first subject to the claims of Distributing's creditors. Under certain circumstances, participants may request a withdrawal of the contributions prior to termination of employment. However, the grant or denial of such a request is within the sole discretion of the plan's administrator. Upon termination of employment, a specified number of shares (based on such factors as years of service and the reason for termination) are distributed to the participant (less required tax withholdings). It is represented that, for all purposes of the Code and ERISA, Plan 5 is an unfunded and unsecured arrangement for the benefit of select members of management or highly-compensated employees.

Prior to the Distribution, Controlled will adopt Plan 6 and will reserve thereunder shares sufficient to satisfy its obligations to complete the Distribution and to cover grants of stock awards in its business for a reasonable time thereafter. Both ISOs and nonstatutory options may be granted under Plan 6. Distributing, Controlled's sole shareholder, will approve Plan 6. Plan 6 will limit the number of shares subject to options that may be granted to any individual during a calendar year and will provide that option grants to "covered employees" will be made by a committee of two or more "outside directors." Options granted under Plan 6 will always be granted with an exercise price that is at least 100 percent of the fair market value of Controlled stock on the date of grant (except for options granted in substitution for options assumed in accordance with § 424(a) of the Code - see below).

Immediately prior to the Distribution, Controlled will grant a nonstatutory option ("Distribution Option") under Plan 6 to each eligible person holding an option

("Corresponding Distributing Option") under the Nonstatutory Option Plans. Each Distribution Option will be for the number of shares of Controlled common stock equal to the product of (a) the number of shares of Controlled common stock that will be distributed for each share of Distributing common stock pursuant to the Distribution, times (b) the number of shares then subject to the applicable Corresponding Distributing Option. The per-share exercise price of a Distribution Option will equal (a) the per-share exercise price of the applicable Corresponding Distributing Option, multiplied by (b) the fair market value per share of Controlled common stock immediately prior to the close of the Distribution ("the Controlled Stock Value"), divided by (c) the last sales price per share of Distributing common stock immediately prior to the Distribution ("the Distributing Stock Value").

A Distribution Option's terms will be identical to the Corresponding Distributing Option's terms immediately prior to the close of the Distribution (e.g., a Distribution Option will be exercisable in the same proportion as the Corresponding Distributing Option was). Immediately prior to the close of the Distribution, the per-share exercise price of a Corresponding Distributing Option will be reduced to a price equal to (a) the per-share exercise price of such Corresponding Distributing Option as in effect immediately prior to such reduction, multiplied by (b) the excess of (1) the Distributing Stock Value over (2) the product of the Controlled Stock Value, times the number of shares of Controlled common stock to be distributed for each share of Distributing common stock outstanding at the close of the Distribution, divided by the Distributing Stock Value. A Distribution Option and a Corresponding Distributing Option will be exercisable independently of the other.

Prior to the Distribution, Controlled will adopt Plan 7. Controlled will reserve thereunder a number of shares sufficient to satisfy its obligations to complete the Distribution and to cover option grants in its business for a reasonable time thereafter. Distributing, as sole shareholder of Controlled, will approve Plan 7.

If an ESPP Option held by an employee of Controlled or a Controlled subsidiary would not be exercisable until after the Distribution, then, immediately prior to the Distribution, Controlled will grant an option under Plan 7 ("Plan 7 Substitute ESPP Option") in substitution for that ESPP Option. Under the terms of Plan 3, ESPP Options automatically terminate when Controlled is no longer a subsidiary of Distributing.

Under the terms of a Plan 7 Substitute ESPP Option, the holder will be able to contribute (through payroll deductions or otherwise) an amount not greater than the amount that could have been withheld to purchase Distributing common stock under the canceled ESPP option. Additionally, each holder of a Plan 7 Substitute ESPP Option will be able to contribute an amount equal to the amount

previously contributed towards the purchase of Distributing common stock under the canceled ESPP Option.

On a Plan 7 Substitute ESPP Option's offering date, its per-share exercise price will be equal to (a) the Controlled Stock Value, multiplied by (b) 85 percent of the fair market value per share of Distributing common stock on the original offering date of the canceled ESPP Option, divided by (c) the Distributing Stock Value. The maximum number of shares that may be purchased under a Plan 7 Substitute ESPP Option will be equal to (a) the maximum number of Distributing shares that could have been purchased under the canceled ESPP Option, multiplied by (b) the per-share "spread value" of the ESPP Option immediately prior to the Distribution, divided by (c) the per-share "spread value" of the Plan 7 Substitute ESPP Option immediately following the Distribution. A Plan 7 Substitute ESPP Option will automatically be exercised on the purchase date specified under the canceled ESPP Option, and its per-share exercise price will be the lesser of: (i) the offering date price determined under the steps set forth above or (ii) 85 percent of the fair market value per share of Controlled common stock on that purchase date.

For all other ESPP Options outstanding at the close of the Distribution, the offering date price and the maximum number of shares that may be purchased under the offering will be adjusted to reflect the Distribution (within the parameters allowed under § 424(a) of the Code). The offering date price will be adjusted to a price equal to (a) the post-Distribution Distributing Stock Value, multiplied by (b) the ESPP offering price, divided by (c) the Distributing Stock Value.

The maximum number of shares that may be purchased under an ESPP Option that has had its offering date price adjusted for the Distribution will equal (a) the maximum number of shares of Distributing common stock that could have been purchased under the option prior to the adjustment of its offering price, multiplied by (b) the per-share "spread value" of the ESPP Option immediately prior to the Distribution, divided by (c) the per-share "spread value" of the ESPP Option immediately following the adjustment of its offering price.

Prior to the Distribution, Plan 4 and Plan 5 will be amended to permit continued retention of a participant's account balances in the trusts established for those plans until the participant's termination of all employment with Controlled and its related companies. The formula for determining the distributable amount under Plan 5 will take into account the participant's employment with Controlled and its related companies. All retained amounts will continue to be first subject to the claims of Distributing's creditors in the event of Distributing's insolvency, but will not be available to creditors of Controlled in the event of Controlled's insolvency. The administrator of Plan 5, in its sole discretion, may direct that all shares of

Controlled common stock received by Plan 5's trust pursuant to the Distribution be sold, and that some or all of the proceeds be invested in shares of Distributing common stock.

Prior to the Distribution, Controlled will adopt a non-qualified deferred compensation plan or plans ("Controlled NQDC Plan(s)") along the lines of Distributing's Plan 4 and Plan 5. It is anticipated that, at inception, the investment selections in the Controlled NQDC Plan(s) will track those in Plan 4. Prior to or within a period not to exceed three months after the Distribution, a participant in Plan 4 and Plan 5 who becomes an employee of Controlled or its subsidiaries may request that his or her balances in the trusts under Plan 4 and Plan 5 be transferred to the trusts established for the Controlled NQDC Plan(s). Whether such request will be granted, when such request will be implemented, and the ancillary terms and conditions which must be satisfied to process such a request will lie within the complete discretion of Distributing. A participant requesting such a transfer will be requested to execute an agreement releasing Distributing from all liabilities that might arise from carrying out the requested transfer. All amounts so transferred will be subject first to the claims of Controlled's creditors in the event of Controlled's insolvency. Controlled may require, as a condition of employment, that a participant in Plan 4 and/or Plan 5 request Distributing to make such a transfer. Transferred assets will remain unsecured and unavailable for personal use by the participant.

The following representations have been made in connection with the proposed transaction:

- (a) Distributing, Controlled and their shareholders will each pay their own expenses, if any, incurred in connection with the proposed transaction.
- (b) The indebtedness owed by Controlled to Distributing after the Distribution of the Controlled stock will not constitute stock or securities within the meaning of § 355.
- (c) 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 the corporation.
- (d) No part of the consideration to be distributed by Distributing will be received by a security holder, if any, as an employee or in any capacity other than that of a security holder of Distributing.
- (e) The five years of financial information submitted on behalf of Distributing's Business C and Business D is representative of the

present operations of Business C and Business D, and with regard to each such business, there have been no significant operational changes since the date of the last financial statements submitted, other than a restructuring of the Business C supply chain to improve customer delivery.

- (f) Following the transaction, other than the overlap of their chairman and CFO, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (g) The Distribution will be carried out for the following corporate business purposes: (i) to protect and enhance the revenues of Business C and Business D; (ii) to better position Business C to obtain access to other technologies necessary to grow its business on the same basis as its competitors; and (iii) to enhance the success of Business C and Business D by enabling the companies to resolve certain conflicts that have arisen in operating Business C and Business D under a single corporate umbrella. The Distribution of the stock of Controlled is motivated, in whole or substantial part, by these corporate business purposes.
- (h) 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, either Distributing or Controlled after the transaction.
- (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 section 4.05(1)(b) of Rev. Proc. 96-30.
- (j) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or dispose of any of the assets of either corporation, except in the ordinary course of business.
- (k) 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 (as determined under § 357(d)) by Controlled

plus, without duplication, any liabilities to which the transferred assets are subject.

- (l) The liabilities assumed (as determined under § 357(d)) by Controlled 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 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) Other than trade account indebtedness created in the ordinary course of business through continuing transactions at terms and conditions arrived at by the parties bargaining at arm's-length, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution of Controlled.
- (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 (See § 1.1502-13 and § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account, if any, with respect to Controlled stock will be included in income, if any, immediately before the Distribution (See § 1.1502-19).
- (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 arms' length.
- (r) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (s) The Distribution is not part of a plan or series of related

transactions (within the meaning of § 355(e)), including the IPO and/or Distributing's acquisition of Target, 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 Distributing or Controlled corporation, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

- (t) The sale of fractional shares in the public market by the exchange agent affecting the transaction and Distribution of cash proceeds thereof among the affected Distributing shareholders is 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 instead of issuing fractional shares of Controlled stock will not exceed one percent of the total consideration that will be issued in the transaction to the Distributing shareholders with respect to their shares of Distributing stock. The fractional share interests in Controlled of each Distributing shareholder will be aggregated, and no Distributing shareholder will receive cash in an amount equal to or greater than the value of one full share of Controlled stock.
- (u) Prior to the Distribution, a Corresponding Distributing Option granted to a "covered employee" of Distributing was excludable as "other performance-based compensation" from "applicable employee remuneration" under § 162(m) of the Code. Distributing was subject to the reporting obligations under section 12 of the Securities Exchange Act of 1934 on the last day of its most recently closed taxable year and continues to be subject to such reporting obligations. Prior to the Distribution, Controlled will be a member of Distributing's affiliated group of corporations within the meaning of § 1504 of the Code (determined without regard to §1504(b) thereunder) and will cease to be such immediately after the Distribution. A committee of two or more "outside directors" of Distributing will approve the grant of Distribution Options to "covered employees" of Controlled. Plan 6 will state a maximum number of shares which may be made subject to awards granted to "covered employees" of Controlled in any calendar year and the aggregate number of shares subject to Distributing Options granted to a "covered employee" of Controlled will not exceed this maximum number. Options granted under Plan 6 will always be granted with an exercise price that is at least 100 percent of the fair market

value of Controlled stock on the date of grant (except for options granted in substitution for options assumed in accordance with § 424(a) of the Code);

- (v) The adjustment of an outstanding option granted under the Nonstatutory Option Plans by reducing the exercise price and supplementing it with the grant of a Distribution Option (with a per-share exercise price that may be less than 50 percent of the fair market value of a share of Controlled common stock on the date of its grant) will conform to generally accepted accounting principles so that the aggregate effect of the adjustments does not increase the “spread” inherent in an outstanding option granted under the Nonstatutory Option Plans prior to its adjustment (i.e., the difference between the Distributing Stock Value and such option’s original exercise price);
- (w) The maximum number of shares that may be purchased under an ESPP Option is calculable on the offering date for such option;
- (x) The approval of Plan 6 by Distributing as sole shareholder of Controlled will comply with all provisions of applicable State law regarding the method and degree of stockholder approval required for the granting of ISOs under a plan;
- (y) The approval of Plan 7 by Distributing as sole stockholder of Controlled will comply with all provisions of applicable State law regarding the method and degree of stockholder approval required for the granting of options under an employee stock purchase plan;
- (z) The definition of “earnings” for purposes of a Controlled Substitute ESPP Option will be identical to that for an ESPP Option, except that “earnings” after the Distribution shall refer only to compensation received from Controlled or its subsidiaries;
- (aa) The shareholders of Distributing have approved the Nonstatutory Option Plans and Plan 3 within twelve months of their respective dates of adoption;
- (bb) Neither Plan 4 nor Plan 5 requires the consent of the participant to transfer the participant’s account balance held therein to the Controlled NQDC Plan(s) or to amend Plan 4 or Plan 5 to permit the respective account balances to remain therein until employment with Controlled terminates or another trigger for Distribution occurs. The right to receive benefits under Plan 4 or

Plan 5 may not be anticipated or assigned by the participant; and

- (cc) A participant will not be able to receive assets held in an account in Plan 4, Plan 5, or the Controlled NQDC Plan(s) for his or her personal benefit until termination of all employment with Controlled and its related companies.

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

- (1) The transfer by Distributing to Controlled of the Business C assets and certain Target assets, solely in exchange for Controlled stock, cash and the assumption by Controlled of liabilities, followed by the pro rata distribution by Distributing of Controlled stock held by Distributing to the shareholders of Distributing, as described above, constitutes a reorganization within the meaning of § 368(a)(1)(D) of the Code. 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 to Distributing upon the transfer of assets, subject to liabilities, to Controlled in exchange for Controlled stock and cash, as described above in steps (ii) and (iii), provided the cash is transferred by Distributing to its creditors in connection with the reorganization described in ruling (1) (§§ 361(a) and 357(a), 361(b)(1)(A) and 361(b)(3)).
- (3) No gain or loss will be recognized to Controlled on the receipt of the assets in exchange for Controlled stock, as described above (§ 1032(a)).
- (4) The basis of the assets received by Controlled will be the same as the basis of such assets in the hands of Distributing immediately prior to the transfer (§ 362(b)).
- (5) The holding period of each asset received by Controlled from Distributing will include the period during which that asset was held by Distributing (§ 1223(2)).
- (6) No gain or loss will be recognized to Distributing upon the Distribution of all of its Controlled stock to the Distributing shareholders (§ 361(c)(1)).
- (7) No gain or loss will be recognized to (and no amount shall be includible in the income of) the shareholders of Distributing upon the receipt of the Controlled stock distributed to them (including any fractional share interest of Controlled to which they may be entitled) (§ 355(a)(1)).
- (8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of each Distributing shareholder (including any fractional share interest of

Controlled to which they may be entitled) immediately after the Distribution will, in each instance, be the same as the basis of the Distributing stock held by such shareholder immediately before the Distribution, allocated in proportion to the fair market value of the shares in accordance with § 1.358-2(a)(2) of the Income Tax Regulations (§ 358(b)(1) and § 358(b)(2)).

- (9) The holding period of the Controlled stock received by the shareholders of Distributing (including any fractional share interest of Controlled to which they may be entitled) will, in each instance, include the holding period of the Distributing stock with respect to which the Distribution will be made, provided that such Distributing stock is held as a capital asset by such shareholder on the date of the exchange (§ 1223(1)).
- (10) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 1.312-10(a) of the Regulations.
- (11) Following the Distribution, Controlled and its direct and indirect subsidiaries that are "includible corporations" (under § 1504(b)) and that satisfy the ownership requirements of § 1504(a)(2) will be an affiliated group of corporations entitled to file consolidated federal income tax returns with Controlled as the common parent.
- (12) Any payments of cash to Distributing shareholders in lieu of fractional share interests in Controlled will be treated for federal tax purposes as if the fractional shares were issued in the Distribution and then were redeemed by Controlled. The cash payments will be treated as having been received as Distributions in full payment in exchange for the stock redeemed as provided in § 302(a) (Rev. Rul. 66-365, 1966-2 C.B. 116). Provided that the fractional share interest is a capital asset in the hands of the recipient shareholder, the gain or loss will constitute capital gain or loss (Rev. Proc. 77-41, 1977-2 C.B. 574 and § 1001).
- (13) Payments 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 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.
- (14) The transfer of Target assets to Controlled followed by the distribution of Controlled stock will not prevent Distributing's acquisition of the assets of Target from qualifying as a reorganization under § 368(a).
- (15) No gain or loss will be recognized to Distributing upon the transfer of Controlled

stock at the exercise of Distribution Options by Distributing service providers.

- (16) No gain or loss will be recognized to Controlled upon the transfer of Distributing stock at the exercise of Corresponding Distribution Options by Controlled service providers.
- (17) No gain or loss will be recognized to Distributing or Controlled on the transfer of assets from Plan 4 and/or Plan 5 to the Controlled NQDC Plans. Transfers of assets at the participant's election during the three month period after the Distribution will be treated as occurring immediately before the Distribution.
- (18) Provided that Distribution Options otherwise met the requirements of § 1.162-27(e)(2)(vi) of the regulations, the compensation received by a "covered employee" (as defined in § 162(m) of the Code), either upon the exercise of a Corresponding Distributing Option (adjusted as described above for the Distribution) or upon the exercise of a Distribution Option granted before the first regularly scheduled shareholders meeting occurring more than 12 months after Controlled becomes a separately-held corporation, will continue to be excludable as "other performance-based compensation." See §§ 1.162-27(e)(2)(iii)(C) and 1.162-27(f)(4)(iii).
- (19) Provided that the options granted under the Nonstatutory Options Plans had no readily ascertainable fair market value when they were granted, and that, after they are adjusted, they will have no readily ascertainable fair market value, no income, gain or loss will be recognized by holders of the options as a result of such adjustments (i.e., adjustments to reflect the change in value of Distributing Common Stock resulting from the Distribution).
- (20) Distributing's approval of Plan 6 will not meet the "shareholder approval requirement" of § 422(b)(1) of the Code. Rather, after the Distribution and public offering, the board of directors and shareholders of Controlled must respectively adopt and approve Plan 6 for that requirement to be met.
- (21) Distributing's approval of Plan 7 will not meet the "shareholder approval requirement" of § 423(b)(2) of the Code. Rather, after the Distribution and public offering, the board of directors and shareholders of Controlled must respectively adopt and approve Plan 7 for that requirement to be met.
- (22) Provided that Plan 3 qualified and Plan 7 qualifies as an "employee stock purchase plan"; that ESPP Options constituted options granted under such a plan; and that the requirements of §§ 424(a)(1) and (2) are satisfied by the Plan 7 Substitute ESPP Options, Plan 7 Substitute ESPP Options will qualify as options granted under an "employee stock purchase plan" as defined in § 423(b).

- (23) The addition of shares to Plan 3 (to cover adjustments to the number of shares subject to options granted under that plan to reflect the Distribution) is not the adoption of a new plan requiring shareholder approval. See § 1.423-2(c)(4) of the regulations.
- (24) Provided that Plan 3 qualified and Plan 7 qualifies as an "employee stock purchase plan"; that ESPP Options constituted options granted under such a plan; and that the requirements of §§ 424(a)(1) and (2) are satisfied by the Plan 7 Substitute ESPP Options, the date of grant of a Plan 7 Substitute ESPP Option will be the same as the date of grant of the corresponding ESPP Option for purposes of the two-year holding period of § 423(a) of the Code.
- (25) No income will be recognized by participants in Plan 4 and Plan 5 by reason of amendments to those Plans permitting continued retention of a participant's account balances until termination of all employment by the participant with Controlled and its related companies.
- (26) No income will be recognized by participants in Plan 5 by reason of any sale by the Plan 5 trust of shares of Controlled common stock received pursuant to the Distribution or the subsequent use of such proceeds by the Plan 5 trust to purchase Distributing common stock.
- (27) The transfer of assets from Plan 4 and Plan 5 to Controlled NQDC Plan(s) will not result in the recognition of income, under § 83 or § 451 of the Code, by the participant requesting the transfer.

Except as ruled above, we express no opinion regarding the federal tax consequences of the above transactions under any provision of the Internal Revenue Code. In this regard, please note that we specifically express no opinion as to whether the shareholder-approval requirements of §§ 422(b)(1) and 423(b)(2) of the Code will be met with respect to Plan 6 or Plan 7. Additionally, except as otherwise stated above, we express no opinion regarding the qualification of any of the options or plans under the rules of § 421 through § 425 of the Code. Finally, we express no opinion concerning whether the amounts deferred under Plan 4 and Plan 5 were properly excluded from the participants' gross incomes for the taxable years in which they were earned, or concerning whether the Controlled NDCQ Plan(s) will properly defer income. In this regard, see Revenue Procedures 92-64 and 92-65 (cited above), which set out the Internal Revenue Service's position concerning nonqualified deferred compensation plans.

We also express no opinion whether Distributing's acquisition (in form) of the stock of Target (step 1) followed by the merger of Target into Target LLC (step 2) constitutes a stock or asset acquisition (step 1) and/or an asset acquisition constituting a tax free reorganization or a liquidation (step 2).

Furthermore, we express no opinion whether Distributing's transfer of intangible property, followed by a transfer of a non-compete agreement in exchange for a royalty-free cross license to the transferred intangible property, as described above in step (ii), represents a transfer of all substantial rights to the transferred intangible property. Therefore, we express no opinion whether Distributing's transfer of intangible property constitutes a reorganization within the meaning of § 368(a)(1)(D) or whether the above rulings apply to that transfer.

In addition, we express no opinion about the tax treatment of the proposed transactions under any other provisions of the Code and regulations promulgated thereunder or the tax treatment of any conditions existing at the time of, or effects from, the proposed transactions that are not specifically covered by the above rulings.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter have not yet been adopted. Therefore, this ruling will be modified or revoked if adopted temporary or final regulations are inconsistent with any conclusions in the ruling. See section 12.04 of Rev. Proc. 2000-1, 2000-1 I.R.B. 4, 46 (January 3, 2000). However, when the criteria in section 12.05 of Rev. Proc. 2000-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

This ruling letter has no effect on any earlier documents, except as described above, and is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter ruling is consummated.

We have sent a copy of this letter to the representative designated in the power of attorney on file in this office.

Sincerely yours,
Assistant Chief Counsel (Corporate)
By: Christopher Schoen
Assistant to the Chief, Branch 1

cc: