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Person to Contact:

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CC:DOM:CORP:5 PLR-103061-99
Date:
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In re:

Distributing =

Controlled =

Business A =

Business B =

M =

N =

Financial Advisor =

Date A =

Date B =

a =

b =

c =

d =

e =

Dear :

This is in reply to a letter dated January 29, 1999, requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was provided in letters dated April 19, and May 10, 1999. The material submitted for consideration is summarized below.

Distributing is the common parent of an affiliated group of corporations that files a consolidated return for federal income tax purposes. Distributing has a single class of stock outstanding, which is widely held and traded on the M.

Distributing is engaged, directly and indirectly through subsidiaries, in Business A and Business B. Distributing has submitted data indicating that Business A and Business B each have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past 5 years.

The assets and liabilities of Business B were transferred from Distributing to Controlled in Date A. In connection with this transfer, Distributing and Controlled entered into certain agreements that provide Distributing and Controlled equal access to certain intellectual property rights for use in their respective businesses (the "Agreements"). The Agreements cross-license the commonly-used intellectual property between Distributing and Controlled. The cross-licensing arrangement provides the non-owner with a perpetual, non-exclusive, royalty-free, worldwide license to use the owner's intellectual property, provided that such use is limited to the non-owner's business. The Agreements also provide that, with respect to certain intellectual property developed by Distributing or Controlled during the 3-year transition period following the IPO described below, the non-owner also will be granted a perpetual, non-exclusive, royalty-free, worldwide license to use such property, as limited to the non-owner's business.

On Date B, Controlled and Distributing completed an initial public offering (the "IPO") of Controlled pursuant to a combined primary and secondary offering. Upon completion of the IPO, Distributing owned, and continues to own as of the date hereof, approximately a percent of the outstanding stock of Controlled. Accordingly, Distributing continues to own an amount of stock of Controlled constituting "control"

within the meaning of § 368(c) of the Internal Revenue Code following the IPO. The remainder of the stock of Controlled is widely held and publicly traded on the N. The outstanding capital stock of Controlled consists of b common shares.

Management and the board of directors of Distributing have determined that it is in the best interests of Distributing to focus on Business A, its core business and, accordingly, to spin-off Controlled's Business B to Distributing's shareholders. The transfer of Business B to Controlled in Date A achieved some separation between Distributing's core business and Business B. However, the taxpayers have provided sufficient documentation that management, systemic and other problems continue to exist because Controlled continues to be controlled by Distributing. For example, Distributing, as an a percent shareholder of Controlled, currently has the ability to elect all of Controlled's board of directors. Four of the seven current directors of Controlled are also officers of Distributing. After the distribution of Controlled stock, none of Distributing's officers or directors will serve as officers or directors of Controlled. The separation will allow Controlled's management to make decisions based on factors relevant to Controlled's success, without having to seek the approval of Distributing's management.

Having determined that the business purpose described above can best be achieved through a distribution of the stock of Controlled (the "Distribution"), management and the board of directors of Distributing have been advised by Financial Advisor that, given the size of Distributing's current position in Controlled and the relatively small public float of Controlled's common stock, a distribution of Distributing's existing a percent interest in Controlled would significantly disrupt the market for shares of Controlled stock, to the detriment of all Controlled shareholders. Based on this advice, Distributing believes that, prior to the Distribution, it must make additional public sales of shares of Controlled stock to increase Controlled's public float. Reducing the amount of Controlled stock that would be distributed in a split-off transaction (either by public or private offerings) also would reduce the risk that shareholders of Distributing would not tender for all of the Controlled stock held by Distributing, and it may reduce the price at which the exchange ratio must be set to encourage a complete split-off.

In order to allow Distributing to sell additional shares of Controlled stock while continuing to own an amount of stock of Controlled constituting "control" within the meaning of § 368(c), Controlled is filing a proxy statement with the Securities and Exchange Commission seeking amendments to its Certificate of Incorporation that will, among other things, create two classes of common stock: (i) class A common stock, entitling the holders thereof to elect up to c percent of Controlled's board of directors (the "Class A Stock") and (ii) class B common stock, entitling the holders thereof to elect the remaining d percent or more of Controlled's board of directors (the "Class B Stock"). The Class A Stock and Class B Stock will have identical rights in all other matters submitted to a vote of shareholders as well as with respect to the payment of dividends and upon liquidation. All of the publicly-held shares of Controlled stock will

be redesignated as Class A Stock, and all of the shares of Controlled stock held by Distributing will be exchanged for an equal number of shares of Class B Stock (the above steps are collectively referred to as the "Recapitalization"). The Class B Stock retained by Distributing would be convertible on a one-for-one basis into Class A Stock at any time prior to the Distribution. In connection with a secondary sale, Distributing will convert an appropriate number of Class B Stock into Class A Stock and immediately sell the Class A Stock.

As a result of the Distribution, the value of Distributing options held by employees and other individuals will be reduced by the relative value of the Controlled stock distributed in the Distribution. The taxpayer has demonstrated that, for several reasons, Distributing might not be able to adjust for the decrease in the value of its options solely by changing the terms of the Distributing options. Thus, Distributing might decide to mitigate this decline in value by retaining shares of Controlled stock and providing Distributing option holders either with direct rights in such retained shares or rights to receive a cash amount. Distributing would arrange to obtain Controlled Class A Stock for this purpose. The total number of retained shares of Controlled Class A Stock would be less than 5 percent of the total outstanding shares of Controlled stock at the time of the Distribution. The Taxpayer has represented that the retention of the Controlled stock will satisfy all of the requirements of Appendix B of Revenue Procedure 96-30, 1996-1 C.B. 696.

Following the Recapitalization, and for the business purpose discussed above, Distributing proposes to distribute all of the Controlled Class B Stock to its shareholders through (a) an exchange of Controlled Class B Stock for Distributing stock ("Split-Off"), (b) a pro rata distribution of Controlled Class B Stock on Distributing stock ("Spin-Off"), or (c) some combination of (a) and (b). The means finally selected will depend on market conditions at the relevant time.

The taxpayers have made the following representations concerning the proposed transaction:

- (a) If the Distribution is completed as a Split-Off, the fair market value of the Controlled Class B Stock and other consideration to be received by each shareholder of Distributing will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.
- (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 Distributing and Controlled is representative of each corporation's present operations,

and with regard to each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

- (d) Following the Distribution, Distributing and Controlled each will continue the active conduct of its business, independently and with its separate employees.
- (e) The Distribution of the Controlled Class B Stock is carried out to address significant fit and focus issues under the current structure. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (f) 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 Distribution.
- (g) There is no plan or intention by Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distribution, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.
- (h) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Distribution, except in the ordinary course of business.
- (i) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution, other than payables and receivables arising in the ordinary course of business.
- (j) 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, 1995-2 C.B. 147, 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 will be included in income immediately before the Distribution (See § 1.1502-19).

- (k) Payments made in all continuing transactions between Distributing and Controlled, other than those transactions contemplated by the Agreements, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arms' length.
- (l) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (m) The Distribution is not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.
- (n) To the best of the knowledge of Distributing's management, no person who is not a qualified U.S. person (under § 1.367(e)-1T of the Temporary Income Tax Regulations) owns, directly, indirectly or constructively (under § 1.367(e)-1T(c)(2)) 5 percent or more of the Distributing stock with respect to which the Distribution will be made.
- (o) Distributing will comply with the reporting requirements of § 1.367(e)-1T(c)(2).

Based on the information submitted and representations made, it is held as follows:

- (1) No gain or loss will be recognized by Distributing upon the distribution of the Controlled Class B Stock to its shareholders (§ 355 (c)(1)).
- (2) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Distributing's shareholders on receipt of the Controlled Class B Stock (§ 355(a)(1)).
- (3) If the Distribution is completed only as a Spin-Off, the aggregate basis of the Controlled Class B Stock and the Distributing stock in the hands of Distributing's shareholders after the Distribution will be the same as the basis of the Distributing stock held immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(a)(1)).
- (4) If the Distribution is completed only as a Split-Off, the basis of the Controlled Class B Stock in the hands of Distributing's shareholders will be the same as the basis of the Distributing stock surrendered in exchange therefor (§ 358(a)(1)).

- (5) If Controlled Class B Stock is received by Distributing shareholders in both a Spin-off and a Split-off, the basis of the Controlled Class B Stock received in the Split-Off will equal the basis of the Distributing stock surrendered therefor, and the basis of the Controlled Class B Stock received in the Spin-Off will equal the shareholder's remaining basis in the shareholder's Distributing stock held immediately before the Spin-Off, allocated between the shares of Distributing stock and Controlled Class B Stock in proportion to the fair market value of each in accordance with § 1.358-2(a) (§§ 358(b) and 358(c)).
- (6) The holding period of Controlled Class B Stock received by a Distributing shareholder in a Spin-Off will include the holding period of the Distributing stock on which the Spin-Off is made, provided the Distributing stock is held as a capital asset on the date of the Spin-Off (§ 1223(1)).
- (7) The holding period of the Controlled Class B Stock received by a Distributing shareholder in a Split-Off will include the holding period of the Distributing stock exchanged therefor, provided the Distributing stock is held as a capital asset on the date of the Split-Off (§ 1223(1)).
- (8) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(b).
- (9) Pursuant to the temporary regulations currently in effect under § 367(e)(1), if Distributing does not distribute Controlled stock to its shareholders having a value of more than 80 percent of the total value of the total outstanding Controlled Class A Common Stock and Controlled Class B Common Stock, then Distributing will recognize gain (as computed in § 1.367(e)-1T(b)(2)) to the extent that the distribution is made to persons who are not qualified U.S. persons as defined in § 1.367(e)-1T(b)(1)(i).
- (10) The retention by Distributing of up to e percent of Controlled's Class A Stock, as described above, will not be in pursuance of a plan having as one of its principal purposes the avoidance of federal income tax within the meaning of § 355(a)(1)(D)(ii).

Temporary or final regulations pertaining to one or more issues addressed in this ruling letter have not yet been adopted. Therefore, this ruling letter may be revoked or modified, in whole or in part, on the issuance of the temporary or final regulations (or a notice with respect to their future issuance). See § 12.04, Rev. Proc. 99-1, 1999-1 I.R.B. 6, which discusses the revocation or modification of ruling letters. However, when the criteria in § 12.05 of Rev. Proc. 99-1 are satisfied, a ruling will not be revoked

or modified retroactively except in rare or unusual circumstances.

We express no opinion about the federal income tax treatment of this 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 transaction that are not specifically covered by the above rulings. In particular, we express no opinion regarding the tax treatment of the Recapitalization. In addition, no rulings were requested and no opinion is expressed concerning the tax treatment of the transfers between Distributing and Controlled of the perpetual, non-exclusive, royalty-free, worldwide licenses for the use of intellectual property, as described above.

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

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

In accordance with the power of attorney on file in this office, the taxpayer will receive a copy of this letter.

Sincerely,

Assistant Chief Counsel (Corporate)

By: _____
Filiz A. Serbes
Assistant to the Chief, Branch 5