

Internal Revenue Service

Department of the Treasury

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Date:

May 17, 2002

Distributing =

Controlled =

Sub 1 =

Acquiring =

Business A =

Business B =

Business C =

Shareholder D =

Shareholder E =

Shareholder F =

Shareholder G =

State H =

Date I =

Date J =

Date K =

Date L =

X Acquisition =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

Dear

This letter responds to your November 19, 2001 request for rulings regarding certain federal income tax consequences of a proposed transaction. Additional information was provided in letters dated March 4, March 21, April 9, April 24, May 3, May 16, and May 17, 2002. The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Summary of Facts

Publicly traded Distributing is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing conducts Business A and Business B directly and through corporate subsidiaries and other entities.

Distributing has a single class of voting common stock outstanding. Distributing also has two series of preferred stock outstanding. Shareholder E owns all of the Distributing preferred stock outstanding, which is convertible, in the aggregate, into approximately a percent of the Distributing common stock outstanding. In addition, Distributing has various stock option plans for its directors and the employees of Distributing and its subsidiaries. Shareholder D and Shareholder E are the only five percent shareholders of Distributing and neither shareholder actively participates in the management or control of Distributing.

Distributing wholly owns Sub 1, which has held certain assets used in Business B for over five years.

Controlled is a wholly owned subsidiary of Distributing that was organized on Date I under the laws of State H.

Publicly traded Acquiring is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Acquiring, through its affiliated group, is engaged in Business C.

Acquiring has a single class of voting common stock outstanding. Since Date J, the Acquiring stock has been subject to a time-phased voting structure. When issued, each share of Acquiring stock has b votes for each matter to which a shareholder is entitled to vote. The Acquiring stock converts to c vote per share upon any transfer or change in beneficial ownership, however, if such converted stock is held for d years without a change in beneficial ownership, such stock re-converts to b votes per share ("Time Phased Voting"). Acquiring also has outstanding approximately e shares of restricted stock and options to acquire approximately f shares of Acquiring stock, which were granted to its employees and directors in connection with the performance of services for Acquiring in the ordinary course of business.

Acquiring has adopted a shareholders rights plan, which provides its shareholders with the right to acquire Acquiring stock at a discount if a person or group acquires b percent or more of Acquiring's outstanding stock (the "Rights Plan").

Among Acquiring's five percent shareholders are Shareholder F and Shareholder G. Neither Shareholder F nor Shareholder G actively participates in the management or control of Acquiring. Information has been submitted suggesting that, after consummation of the transactions described below, Shareholder F and Shareholder G may acquire additional shares of Acquiring stock. Shareholder F and Shareholder G will not own, immediately after the transactions described below, five percent or more of the Acquiring stock outstanding.

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

In order to focus more on certain businesses, Distributing decided on Date K to divest itself of Business B because that business was no longer a strategic fit for Distributing. Acquiring conducts a business that is a strategic fit with Business B and desires to acquire Business B without Distributing becoming a principal shareholder of Acquiring.

Proposed Transaction

To achieve Distributing's divestiture of Business B and to facilitate the acquisition of Controlled by Acquiring, Distributing has proposed the following series of transactions (the "Proposed Transaction"):

- (i) Sub 1 will transfer certain assets used in Business B to Distributing.
- (ii) Distributing will transfer the assets (including the assets received from Sub 1) and certain liabilities of Business B to Controlled (the "Contribution").
- (iii) Promptly following the Contribution, Distributing will deliver (or cause to be delivered) a certificate representing all of the Controlled stock to an exchange agent acting on behalf of the holders of Distributing's common stock (the "Distribution"). The number of shares of Controlled stock represented by the certificate will equal that number of shares of Distributing common stock outstanding on the record date for the Distribution.
- (iv) Immediately after the Distribution, Controlled will merge into Acquiring under State H law, and Acquiring will be the surviving corporation (the "Merger"). The Merger will be approved before the Distribution by Distributing as the sole shareholder of Controlled. In the Merger, each share of Controlled stock will be converted into g of a share of Acquiring stock. Each share of Acquiring stock outstanding immediately

before the Merger will be converted into that fraction of a share of Acquiring stock that results in the Acquiring shareholders collectively receiving, as a result of the ownership of Acquiring stock before the Merger, not more than h percent of the Acquiring stock outstanding immediately after the Merger. Fractional shares of Acquiring stock will be aggregated and transferred to an exchange agent on behalf of the shareholders for sale in the open market. The proceeds from such sales will then be delivered to the shareholders who would otherwise have received the fractional shares. Thus, as a result of the Merger, the shareholders of Controlled will receive more than 50 percent of the outstanding Acquiring stock.

(v) In connection with the Merger, Acquiring will amend its articles of incorporation to provide that each share of Acquiring's stock outstanding after the Merger will have c vote for purposes of electing directors and for all other purposes with the exception of certain specific matters that are listed in Acquiring's articles of incorporation (the "Specific Matters"). The Time Phased Voting feature of the Acquiring stock, as described above, will continue to apply to such stock but only with regard to the Specific Matters.

The Specific Matters will include: (a) voting on a dissolution or liquidation of Acquiring; (b) the adoption of any amendment to the articles of incorporation or bylaws of Acquiring (other than amendments that would increase the number of votes to which the holders of Acquiring's stock are entitled or that would expand or otherwise change what is a Specific Matter); (c) matters relating to the Rights Plan; (d) matters relating to any stock option plan, stock purchase plan, executive compensation, executive benefit plan, or other similar plan or arrangement; (e) adoption of any plan for a merger, consolidation, or majority share acquisition of Acquiring or any subsidiary of Acquiring, or the lease, sale or other disposition of all, or substantially all, of Acquiring's assets; (f) matters under Articles i and j of Acquiring's articles of incorporation or any issuance of Acquiring's stock for which shareholder approval is required by applicable stock exchange rules; and (g) matters relating to the issuance or repurchase of Acquiring's stock that Acquiring's board of directors determines is required or appropriate to be submitted to shareholders under State H law or applicable stock exchange rules.

With regard to the Specific Matters related to amendments to Acquiring's articles of incorporation and bylaws, it is significant that Acquiring's Board of Directors currently have the powers that are traditionally decided by a board of directors to manage Acquiring in the manner they see fit. The bylaws, for instance, dated Date L, currently govern, among other things, matters relating to meetings of shareholders and of Acquiring's board of directors, such as the number, classification, and term of Acquiring's directors.

With regard to the Specific Matters related to Articles i and j, Article i of Acquiring's articles of incorporation will apply where some entity that is the direct or indirect beneficial owner of k percent or more of Acquiring's stock seeks to effect a "business combination" with Acquiring. In that case, Article i requires the affirmative

vote of the holders of 1 percent of all shares entitled to vote for directors to approve the transaction, unless certain “fair price” and other conditions are met. Article j of Acquiring’s articles of incorporation will require, to approve a “control share acquisition”, the approval of a majority of Acquiring’s shareholders’ voting power represented at the meeting, both including and excluding voting power attributable to interested shareholders.

With regard to the Specific Matters relating to any stock option plan, stock purchase plan, executive compensation plan, executive benefit plan, or other similar plan or arrangement, such matters may only be submitted to the Acquiring shareholders for their approval if so required by law, applicable stock exchange rules, or pursuant to the discretion of Acquiring’s board of directors.

(vi) In connection with the Proposed Transaction, Distributing, Controlled, and Acquiring will have entered into a Merger Agreement, a Contribution Agreement, a Tax Sharing Agreement, a Transitional Services Agreement, a Manufacturing Plant Separation Agreement, and other agreements dealing with intellectual property assignment and licensing (the “Ancillary Agreements”) for various periods after the Proposed Transaction.

Contribution and Distribution Representations

The taxpayer has made the following representations concerning the Contribution and the Distribution:

(a) The indebtedness, if any, owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

(b) No part of the Controlled stock to be distributed by Distributing to its shareholders is being received by a Distributing shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) The five years of financial information submitted on behalf of Business A is representative of Business A’s present operations, and there have been no substantial operational changes since the date of the last financial statements submitted, except for the X Acquisition.

(d) The five years of financial information submitted on behalf of Business B is representative of Business B’s present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.

(e) Following the Proposed Transaction, Distributing and Controlled (or their corporate successors) will each continue the active conduct of their respective businesses, independently and with their separate employees, except for services to be provided by Distributing to Acquiring for a transitional period following the Merger.

(f) The gross assets of Business A will have a fair market value equal to or greater than five percent of the total fair market value of the gross assets of Distributing and the gross assets of Business B will have a fair market value equal to or greater than five percent of the total fair market value of the gross assets of Controlled.

(g) The Distribution is carried out for the corporate business purpose of achieving Distributing's strategic divestiture objectives for Business B and facilitating the Merger. The Distribution is motivated, in whole or substantial part, by such corporate business purposes.

(h) There is no plan or intention by any Distributing shareholder who owns five percent or more of the Distributing stock, and the Distributing management, 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, any of Distributing, Controlled, or Acquiring after the Proposed Transaction, except pursuant to the Merger.

(i) There is no plan or intention by Distributing, Controlled, or Acquiring, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Proposed Transaction, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, 705.

(j) There is no plan or intention to liquidate any of Distributing, Controlled, or Acquiring, to merge any of such corporations with any other corporation (except pursuant to the Merger), or to sell or otherwise dispose of the assets of any of such corporations after the Proposed Transaction, 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 by Controlled, plus any liabilities to which the transferred assets are subject; and the liabilities assumed in such transfers 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.

(l) 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, Stat.1388, 536 (1990), if applicable) to reflect an early disposition of any such property with respect to which the recapture period has not closed or to which § 50(a)(2) applies.

(m) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.

(n) Except for obligations for payments made under the Ancillary Agreements, no intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.

(o) 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, any excess loss account with respect to the Controlled stock will be included in income immediately before the Distribution (See § 1.1502-19).

(p) Payments made in connection with all continuing transactions among Distributing, Controlled, and Acquiring will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(q) No two parties to the Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(r) 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 date of the Distribution.

(s) 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 date of the Distribution 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 date of the Distribution.

(t) 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 entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

Merger Representations

The taxpayer has made the following representations concerning the Merger:

(u) The fair market value of the Acquiring stock and the cash received for fractional shares received by each Controlled shareholder will be approximately equal to the fair market value of the Controlled stock surrendered in exchange therefor.

(v) At least 50 percent of the proprietary interest in Controlled will be exchanged for Acquiring's stock and will have been preserved within the meaning of § 1.368-1(e) of the Income Tax Regulations.

(w) In connection with the Merger, neither Acquiring, nor any person related to Acquiring (within the meaning of § 1.368-1(e)(3) of the Income Tax Regulations) has any plan or intention to reacquire any Acquiring stock issued in the Merger with respect to Controlled stock in exchange for any consideration other than Acquiring stock.

(x) Acquiring has no plan or intention to sell or otherwise dispose of any of the assets of Controlled acquired in the Merger, except for dispositions made in the ordinary course of business or transfers described in § 368(a)(2)(C).

(y) The liabilities of Controlled assumed by Acquiring and the liabilities to which the transferred assets of Controlled are subject were incurred by Controlled in the ordinary course of its business.

(z) Following the Merger, Acquiring will continue the historic business of Controlled or use a significant portion of Controlled's historic business assets in a business.

(aa) Acquiring, Distributing, Controlled, and the Controlled shareholders will pay their respective expenses, if any, incurred in connection with the Merger.

(bb) There is no intercorporate indebtedness existing between Controlled and Acquiring that was issued, acquired, or will be settled at a discount.

(cc) No two parties to the Merger are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(dd) Controlled is not under the jurisdiction of a court in a title 11 or similar case under § 368(a)(3)(A).

(ee) The fair market value of the Controlled assets to be transferred to Acquiring will equal or exceed the sum of the liabilities assumed by Acquiring plus the amount of the liabilities, if any, to which the transferred assets are subject.

(ff) The total adjusted basis of the Controlled assets to be transferred to Acquiring will equal or exceed the sum of the liabilities assumed by Acquiring, plus the amount of the liabilities, if any, to which the transferred assets are subject.

(gg) None of the compensation received by any shareholder-employee of Controlled will be separate consideration for, or allocable to, any of their shares of Controlled stock; none of the shares of Acquiring stock received by any shareholder-employee of Controlled will be separate consideration for, or allocable to, any employment agreement; and the compensation paid to any shareholder-employee of Controlled will be for services actually rendered and will be commensurate with amounts paid to third parties bargaining at arm's length for similar services.

(hh) The payment of cash in lieu of fractional shares of Acquiring stock is solely for the purpose of avoiding the expense and inconvenience to Acquiring of issuing fractional shares and does not represent separately bargained-for consideration. Distributing estimates that the total cash consideration that will be paid in the Merger to the Controlled shareholders instead of issuing fractional shares of Acquiring stock will be approximately m percent of the total consideration that will be issued in the Merger to the Controlled shareholders in exchange for their shares of Controlled stock.

Contribution and Distribution Rulings

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

(1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" under § 368(b).

(2) No gain or loss will be recognized by Distributing on the Contribution (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).

(4) The basis of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the transfer (§ 362(b)).

(5) The holding period of each asset received by Controlled in the Contribution will include the period during which Distributing held that asset (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing on the Distribution (§§ 355(c) and 361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholders on the receipt of Controlled stock in the Distribution (§ 355(a)(1)).

(8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of each Distributing shareholder immediately after the Distribution will equal the aggregate basis of the Distributing stock held by that shareholder immediately before the Distribution, allocated between Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 358(b)(2), § 358(c), and § 1.358-2(a)(2).

(9) The holding period of the Controlled stock received by each Distributing shareholder in the Distribution will include the holding period of the Distributing common stock on which the Distribution is made, provided the Distributing common stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(10) Earnings and profits will be allocated between Distributing and Controlled in accordance with §§ 312(h) and 1.312-10(a).

(11) Any payments made between Distributing and Controlled, or their subsidiaries and successors under the Tax Sharing Agreement regarding tax liabilities that (a) relate to a taxable period ending on or before the Proposed Transaction or to a taxable period beginning before and ending after the Proposed Transaction, and (b) do not become fixed and ascertainable until after the Proposed Transaction, will be treated as occurring immediately before the Distribution.

(12) The Time Phased Voting feature of the Acquiring stock as it relates to the Specific Matters will not be taken into account for purposes of determining whether one or more persons acquired a 50 percent or greater interest in Controlled as part of a plan or series of related transactions that includes the Distribution under § 355(e).

(13) Any Acquiring stock acquired after the Proposed Transaction by an employee or director of Acquiring in connection with the performance of services for Acquiring in a transaction to which § 83 applies (including acquisitions of Acquiring stock pursuant to the exercise of stock options granted to an employee or director of Acquiring before the Proposed Transaction) and that is not excessive by reference to the services performed will not be treated as acquired as part of a plan or series of related transactions that includes the Distribution under § 355(e).

(14) Fractional shares of Acquiring stock sold by the exchange agent will be treated as received by the Controlled shareholders in the Merger and then disposed of by such shareholders in transactions that are not part of a plan or series of related transactions that includes the Distribution under § 355(e).

Merger Rulings

Pursuant to § 3.01(29) of Rev. Proc. 2001-3, 2001-1 C.B. 111, 114, the Internal Revenue Service will not rule as to whether a proposed transaction constitutes a corporate reorganization under § 368(a)(1)(A) and the various consequences resulting from the application of that section, unless the Service determines that the transaction presents a significant issue that must be resolved to decide those matters. In that case, the Service will rule on the entire transaction. The taxpayer has provided information sufficient to show that the Merger presents a significant issue under § 3.01(29) of Rev. Proc. 2001-3.

Accordingly, based solely on the information submitted and the representations set forth above, we rule as follows regarding the Merger:

(15) Provided the Merger qualifies as a statutory merger under applicable State H law, the Merger will qualify as a reorganization under § 368(a)(1)(A). Controlled and Acquiring each will be “a party to a reorganization” under § 368(b).

(16) No gain or loss will be recognized by Controlled on the Merger (§§ 361(a) and 357(a)).

(17) No gain or loss will be recognized by Acquiring on the Merger (§ 1032(a)).

(18) The basis of each asset received by Acquiring in the Merger will equal the basis of that asset in the hands of Controlled immediately before the Merger (§ 362(b)).

(19) The holding period of each asset received by Acquiring in the Merger will include the period during which Controlled held that asset (§ 1223(2)).

(20) No gain or loss will be recognized by the Controlled shareholders on the exchange of their Controlled stock for Acquiring stock in the Merger (§ 354(a)(1)).

(21) The basis of the Acquiring stock (including any fractional share interest to which the shareholder may be entitled) received by each Controlled shareholder in the Merger will equal the basis of the Controlled stock surrendered by that shareholder in exchange therefor (§ 358(a)(1)).

(22) The holding period of the Acquiring stock (including any fractional share interest to which the shareholder may be entitled) received by each Controlled shareholder in the Merger will include the holding period of the Controlled stock surrendered in exchange therefor, provided the Controlled stock is held as a capital asset on the date of the Merger (§ 1223(1)).

(23) If cash is received by a Controlled shareholder as a result of a sale of a fractional share of Acquiring stock by the exchange agent on behalf of such shareholders, the Controlled shareholder will recognize gain or loss measured by the difference between the amount of the cash received and the basis of the fractional share (§ 1001). Provided the fractional share interest is a capital asset in the hands of

the exchanging shareholder, the gain or loss will be capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code (§§ 1221 and 1222)

Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Internal Revenue Code or regulations or 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

This ruling letter 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 covered by this letter is completed.

Under a power of attorney on file in this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,
Stephen P. Fattman
Acting Special Counsel to the
Associate Chief Counsel (Corporate)
Office of the Associate Chief Counsel
(Corporate)

cc: