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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

March 14, 2001

LEGEND:

Distributing =

Controlled =

Business A =

Business B =

Business C =

State A =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Subsidiary 1 =

PLR-111625-01

Subsidiary 2 =

p =

Investment
Bank =

Acquisitions =

Less Recent =

Recent =

Dear:

This letter responds to your letter dated February 7, 2001, requesting rulings as to the federal income tax consequences of a proposed transaction. The information submitted in that letter and other correspondence is summarized below.

Distributing, a publicly held domestic corporation and common parent of a consolidated group, is organized under the laws of State A. Approximately p million shares of Distributing common stock are outstanding. No person holds five percent or more of Distributing's common stock. Distributing has no other class of stock outstanding. Distributing is authorized to issue preferred stock, but none is outstanding.

Distributing is directly engaged in Business A and Business B. Distributing recently spun off Business C in a transaction that was the subject of a prior ruling letter ("Prior Ruling Letter") issued on Date 2. In that letter, we ruled that the Business C spin-off qualified as a tax-free distribution under § 355 of the Internal Revenue Code.

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

Controlled, a wholly-owned subsidiary of Distributing, is organized under the laws of State A. It was previously a shell corporation that, as a temporary matter, had outstanding a small number of shares of a single class of common stock ("Transitional Stock"). Prior to the Contribution described below, Controlled was not engaged in business activities. In the Contribution, Controlled acquired Business B from Distributing and is, and will continue to be, directly engaged in Business B. As described below, as part of the overall plan, Controlled will change its stock structure so as to have outstanding two classes of stock, Class A common stock ("Class A Stock") and Class B common stock ("Class B Stock"). At present, however, Controlled has

PLR-111625-01

outstanding solely Transitional Stock, all of which is held by Distributing

Subsidiary 1 and Subsidiary 2 are each wholly-owned subsidiaries of Distributing organized in State A. Subsidiary 1 and Subsidiary 2 were formed to hold and manage Distributing's portfolio of patents and patent applications relating predominantly to Business B.

Distributing has provided substantiation that separating Businesses A and B will benefit Business A because it will allow top management to focus exclusively on the problems of, and opportunities for, that business. Moreover, Distributing has determined that the separation of Business B from Business A will significantly improve Business B's competitive position, eliminate serious strategic conflicts between Business A and Business B, and enable Business A and Business B to each sharpen its "fit and focus." Business A and Business B are, in part, engaged in different aspects of the same industry with customers of Business B being competitors of Business A. One potentially major customer of Business B has indicated that the present relationship of Business B with Business A is an obstacle to increased purchasing of Business B products. Finally, Distributing's management believes separating the two businesses will improve Business B employee morale and will significantly boost these employees' motivation. Accordingly, the following steps have been undertaken, or are proposed, by the taxpayer:

- I. Distributing recently contributed to Controlled (the "Contribution") the assets used predominantly in Business B, including the stock of Subsidiary 1 and Subsidiary 2 and certain U.S. and non-U.S. subsidiaries, with Controlled assuming certain liabilities related to Business B. Also, in lieu of certain nonassumable debt related to Business B, Controlled is assuming from Distributing certain borrowings under an assumable facility of Distributing (the "Debt Assumption"). No additional stock of Controlled was issued. Thus, at the end of this step, Controlled had outstanding only the Transitional Stock.
- II. Shortly after Step I (within 90 days or less of the Contribution), after determining the appropriate number of shares of Controlled Class A Stock and Class B Stock for purposes of the subsequent steps, Distributing will have its Transitional Stock in Controlled converted into Class B Stock, having four votes per share, and then the necessary amount of the Class B Stock will be converted into Class A Stock, having one vote per share. Thus, at the end of this step, instead of the Transitional Stock, Distributing will hold all the Class A Stock and all the Class B Stock which will constitute all the outstanding stock in Controlled.
- III. At one or more times prior to Step V, below, Distributing will transfer shares of Class A Stock to Investment Bank in exchange for outstanding Distributing obligations held by Investment Bank (the "Exchange"). (Some or all of these Distributing obligations will have been acquired by Investment Bank in anticipation of this Exchange.)

PLR-111625-01

- IV. Controlled will issue shares of Class A Stock to the public in an initial public offering (the "IPO"). In addition, Investment Bank will attempt to sell to the public the Class A Stock it receives in Step (III). At this point, some or all of the outstanding Class A Stock will be held by the public and/or Investment Bank and all the Class B stock and, possibly, some Class A Stock will be held by Distributing.
- V. Distributing will distribute (the "Distribution") to its shareholders all the Controlled stock it then holds (all of the Class B Stock and any remaining Class A Stock), which will constitute over 80% of the combined voting power of all the outstanding stock in Controlled. The distribution will be pro rata to the Distributing shareholders and the shareholders will not surrender any Distributing stock. In addition, options to purchase Distributing stock held by persons who become employees of Controlled will be converted into options to purchase Controlled stock.

In conjunction with the proposed transactions, Distributing and Controlled will enter into several agreements relating to their separation, including transitional services agreements and a tax sharing agreement. Also, one director of Distributing will be appointed a director of Controlled and will continue to serve as a director of Distributing.

Since it became an independent company on Date 9, Distributing has issued Distributing common stock as consideration in the Acquisitions. The most recent of these acquisitions, the Recent Acquisitions, were consummated in calendar year 2000. In the two years preceding the Distribution, Distributing has issued stock on the exercise of employee stock options. Distributing also may institute a stock repurchase program that includes open market purchases as well as derivatives transactions such as puts and calls with investment and commercial banks. Controlled may also enter into a similar stock repurchase program. In the derivatives transactions, the banks acting on behalf of Distributing and Controlled will be unrelated third parties. In no instance will either Distributing or Controlled be able to identify any person from whom Distributing or Controlled stock is obtained as a result of these derivatives transactions.

Prior to, or at the time, Distributing assets are transferred to Controlled, the Controlled stock held by Distributing will have been pledged as collateral to support Distributing's obligation to repay certain loans. Shortly prior to the Step III Exchange and Step IV IPO, the collateral lien will be released on the Controlled stock to be used in the Exchange and IPO. Similarly, shortly prior to the Step V Distribution, the collateral lien will be released on all the remaining Controlled stock held by Distributing.

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

- (a) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing will each equal or exceed the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.

PLR-111625-01

- (b) The liabilities to be assumed by Controlled in the Contribution, and the liabilities to which the assets transferred to Controlled in the Contribution are subject, were incurred in the ordinary course of business and are associated with the assets transferred. The debt assumed in the Debt Assumption is under a new borrowing facility because Distributing's other liabilities are not assumable. In effect, the debt assumed in the debt assumption is the equivalent of other ordinary-course debt that Distributing's creditors will not permit Distributing to transfer.
- (c) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of this transaction other than the payment of certain payables with the proceeds of the debt assumed by Controlled in the Debt Assumption.
- (d) No investment credit has been or will be claimed with respect to any property being transferred between Distributing and Controlled.
- (e) Immediately prior to the Distribution, the only outstanding stock in Controlled not held by Distributing will be shares of voting Class A Stock held by the public and/or Investment Bank. These shares of Class A Stock that Distributing does not own will hold less than 20 percent of the then outstanding vote in Controlled and will constitute less than 45 percent of the value of all the outstanding Controlled stock.
- (f) Each share of Class B Stock will be convertible, while held by Distributing before the Distribution, into one share of Class A Stock. After the Distribution, the Class B Stock will not be convertible into any other class of Controlled stock. The Class A Stock will not be convertible at any time into any other class of Controlled stock. Controlled will not have any class of stock outstanding except its Class A Stock and Class B Stock.
- (g) The transaction will not constitute a disqualified distribution within the meaning of § 355(d). For purposes of § 355(d), immediately after the Distribution, no person will hold disqualified stock (under § 355(d)(3)), in Distributing or Controlled, possessing 50 percent or more of the total combined voting power of all classes of Distributing or Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing or Controlled stock.
- (h) The Distributing shareholders will receive solely shares of Controlled stock (Class B Stock and, possibly, Class A Stock) in the Distribution.
- (i) Distributing, Controlled and their shareholders will each pay their own expenses incurred in connection with all the above steps.
- (j) No part of the stock in Controlled received by the Distributing shareholders in the Distribution is being received by a shareholder as a creditor, employee, or in any capacity other than as a shareholder of Distributing.

- (k) Both Business A and Business B will have been actively conducted (within the meaning of § 1.355-3(b) of the Income Tax Regulations) by Distributing using its own employees at all times throughout the 5-year period immediately preceding the Distribution (or actively conducted by a predecessor company from whom Distributing received the businesses in a transaction in which gain or loss was not recognized). The 5 years of financial information submitted on behalf of Distributing's Business A and Business B is representative of each business's present operations and, regarding each business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (l) Following the Distribution, Distributing and Controlled will each continue the active conduct (within the meaning of § 1.355-3(b)) of Business A and Business B, respectively, independently and with their own separate employees. With regards to each of Business A and Business B, at the time of the Distribution, the gross assets of the business that are relied on to satisfy the active business requirement of the regulations will have a fair market value that is 5 percent or more of the total fair market value of the corporation conducting the business.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (n) For simplicity, certain short-term services undertaken to facilitate the separation will be paid at cost. All other transactions between Distributing and Controlled will be paid for at fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (o) The Distribution is being carried out for the following corporate business purposes: (i) to improve "fit and focus" and allow top management of each business to deal exclusively with the problems and opportunities of that single business; and (ii) to improve Business B's competitive position and employee morale.
- (p) The Distribution is being undertaken for the business purposes indicated in the prior representation and is not motivated by any purpose of facilitating the acquisition of Distributing common stock in any Acquisition or any similar transaction. Similarly, each of the Acquisitions was undertaken for valid business reasons independent of the Distribution. The Distribution would have occurred at approximately the same time and in a similar form regardless of any Acquisition, and each Acquisition would have occurred at approximately the same time and in a similar form regardless of the Distribution.
- (q) In conjunction with the Less Recent Acquisitions, Distributing did not discuss the Distribution with any person (or a controlling shareholder of such a person) who acquired Distributing stock in any of these Acquisitions.

- (r) At the times the Less Recent Acquisitions were consummated, no significant action had been taken by Distributing with regard to the proposed Distribution. At the times these Less Recent Acquisitions were consummated, there was no agreement, understanding, arrangement or substantial negotiations concerning the Distribution. Prior to Date 1, Distributing's management's strategic thinking had been that Business B should be retained by Distributing because it was an important part of its growth strategy. It was only subsequent to Date 1 that Distributing's management commenced serious consideration of distributing Business B, and some months later, on Date 3, that Distributing's Board of Directors first considered the proposed transactions. The Board of Directors approved the proposed transactions on Date 4 (more than 6 months after the last to occur of the Less Recent Transactions). Distributing publicly announced its intention to effect the Distribution on Date 5 and expects to complete the Distribution between Date 6 and Date 7 (approximately 2 years after consummation of the last of the Less Recent Transactions). In contrast, some or all of the Recent Transactions (though having independent motivation) were consummated at a time when Distributing's management was seriously contemplating the proposed Distribution. The Recent Transactions involved issuances that totaled less than 5 percent of the vote and value of Distributing's outstanding stock.
- (s) There is no plan or intention to liquidate either Distributing or Controlled, to merge either Distributing or Controlled with any other corporation, or to sell or otherwise dispose of the assets of either Distributing or Controlled, subsequent to the Distribution, except in the ordinary course of business. It is possible, however, that certain subsidiaries of Distributing may be merged into Distributing and certain subsidiaries of Controlled may be merged into Controlled.
- (t) The issuance of Class A Stock and Class B Stock in Step II will effect a "permanent realignment of voting control," within the meaning of Rev. Rul. 69-407, 1969-2 C.B. 50, and there will be no plan or arrangement to unify the Class A Stock and the Class B Stock within 5 years of the Distribution or to engage in any other transaction that would result in the shares of Class A Stock issued in Steps III and IV above (or any successor shares) having a vote in excess of 20 percent of the total vote in Controlled, or in any transaction that would result in these shares of Class A Stock (or any successor shares) ceasing to be voting stock.
- (u) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary, to purchase any of its outstanding stock subsequent to the Step V Distribution, other than through stock purchases meeting the requirements of Section 4.05(1)(b) of Rev. Proc. 96-30 and stock purchases by Distributing or Controlled in connection with derivatives transactions entered into by Distributing or Controlled (respectively) in connection with their stock repurchase programs.

PLR-111625-01

- (v) To the best knowledge of Distributing's management, there is no plan or intention by shareholders of Distributing to sell, exchange, transfer by gift, have redeemed or otherwise dispose of any of their stock in Distributing or Controlled subsequent to the Step V Distribution, except sales of fractional shares of Controlled stock distributed in the Distribution.
- (w) Neither Distributing nor Controlled is, or following the above transaction is planned, intended or expected to be, an S corporation.
- (x) Neither Distributing nor Controlled is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).
- (y) 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 Treas. Reg. § 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; Treas. Reg. § 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account, if any, with respect to the Controlled stock and the excess loss account, if any, with respect to the stock of any subsidiary owned by Controlled directly or indirectly, will be included in income immediately before the Distribution (see § 1.1502-19).
- (z) The Distributing share purchase rights and the Controlled share purchase rights are each the type of rights described in Rev. Rul. 90-11, 1990-1 C.B. 10.
- (aa) Some of the Distributing obligations acquired by Investment Bank and then transferred by Investment Bank to Distributing in return for Class A Stock in the Exchange might qualify as securities of Distributing.
- (bb) Investment Bank will be acting for its own account in acquiring Distributing obligations before the Exchange, exchanging those Distributing obligations for shares of Class A Stock in the Exchange, and attempting to sell its Class A Stock to the public.
- (cc) The Step II change in the outstanding Controlled stock from Transitional Stock to Class A Stock and Class B Stock was undertaken in the manner described in order to expeditiously obtain the appropriate number of shares of each class while at the same time meeting the requirements of applicable state and federal corporate and securities law. Except for the reasons stated in the preceding sentence, the Class A Stock and Class B Stock would have been issued at the time of the Step I Contribution. At the time Step I was undertaken: (i) the present overall plan requiring Class A Stock and Class B Stock had already been adopted; and (ii) both Distributing and Controlled planned and intended for the Class A Stock and Class B Stock to be issued.

PLR-111625-01

- (dd) All of the steps, including the Step I Contribution and the Step V Distribution, are part of a single overall plan. The Step I Contribution is being undertaken in order to enable the Step V Distribution to be undertaken. The Step V Distribution will be consummated no later than the end of the taxable year of Distributing in which Distributing undertook Step I.

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

- (1) For federal income tax purposes, the Class A Stock and Class B Stock held by Distributing at the end of Step II will be considered as being received by Distributing in exchange for the assets transferred to Controlled in the Step I Contribution.
- (2) The Contribution followed by the Distribution is a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be a "party to a reorganization" within the meaning of § 368(b).
- (3) No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for Controlled stock and the assumption of liabilities by Controlled in the Contribution and the Debt Assumption (§§ 361(a) and 357(a)).
- (4) No gain or loss will be recognized by Controlled on the receipt of Distributing assets in exchange for Controlled stock (§ 1032(a)).
- (5) The basis of each asset received by Controlled will be the same as the basis of such asset in the hands of Distributing immediately prior to the transfer (§ 362(b)).
- (6) The holding period of the assets received by Controlled will include the period during which such assets were held by Distributing (§ 1223(2)).
- (7) The Class A Stock received by Distributing in Step II will constitute "qualified property" within the meaning of § 361(c)(2)(B) (see rulings (1) and (2), above). The transfer by Distributing to its creditor, Investment Bank, of this Class A Stock constituting qualified property will not result in the recognition of gain or loss to Distributing (§ 361(c)(1) and (3)).
- (8) No gain or loss will be recognized by Distributing upon the distribution to its shareholders of Controlled stock in the Distribution (§ 361(c)(1)).
- (9) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders upon receipt of Controlled stock (including fractional share interests) in the Distribution (§ 355(a)(1)).
- (10) The total of the basis of the Controlled stock (including fractional share

interests) plus the basis of the Distributing stock held by each shareholder of Distributing after the Distribution will be the same as the basis of the Distributing stock held by such shareholder immediately before the Distribution. The total basis will be allocated in proportion to the relative fair market values of the Controlled stock and Distributing stock in accordance with § 1.358-2(a)(2).

- (11) The holding period of the Controlled stock (including fractional share interests) to be received by the shareholders of Distributing will include the holding period of the Distributing stock with respect to which the Distribution is made, provided that the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (12) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a).
- (13) Grants of compensatory options by Distributing and exercises of compensatory options will not be taken into account for purposes of § 355(e).
- (14) The issuance by Distributing of its common stock in the Less Recent Acquisitions will not be taken into account for purposes of § 355(e).

No opinion is expressed as to whether the issuances of Distributing stock in the Recent Acquisitions will be taken into account for purposes of § 355(e). No opinion is expressed as to the federal income tax consequences under § 367 or related provisions of any transfer of stock of non-U.S. subsidiaries. Except as provided in the above rulings, no opinion is expressed as to any aspect of the transactions involving Investment Bank (including Investment Bank's participation in Steps III and IV, above), or as to the effect on Distributing of its acquisition of its debt through Investment Bank including: (i) whether Investment Bank in any part of the transactions acted as an agent for Distributing; (ii) whether Distributing should be considered to have directly acquired its debt from the creditors who held the debt prior to Investment Bank; (iii) whether any of the Distributing obligations constitute Distributing securities that should be considered transferred to Distributing by Investment Bank in an exchange in which gain or loss is not recognized to Investment Bank, either because the securities are considered exchanged for Controlled stock as part of the Distribution or because they are considered exchanged for Distributing stock in a § 368(a)(1)(E) recapitalization; (iv) whether Distributing's acquisition of its own debt results in income from discharge of indebtedness pursuant to §§ 61(a)(12) and 1.61-12 or any other provisions; or (v) whether the acquisition of Distributing debt requires any adjustment to basis in depreciable property, net operating loss carryovers, or any tax attributes under section 108(b) or other provisions relating to the reduction of tax attributes. Moreover, no opinion is expressed about the tax treatment of any of the above steps under any other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the above steps not specifically covered by the above rulings.

The present ruling letter will have no effect on our Prior Ruling Letter.

PLR-111625-01

This ruling is directed only to the taxpayers who requested it. Section 6110(j)(3) of the Code provides that this private letter ruling may not be used or cited as precedent.

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this letter are consummated.

Pursuant to the power of attorney on file in this matter, a copy of this letter is being sent to your authorized representative.

Sincerely,
Associate Chief Counsel (Corporate)
By Christopher Schoen
Assistant Branch Chief, Branch 1