

Internal Revenue Service

Department of the Treasury

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Refer Reply To:
CC:CORP:B03 - PLR-117209-02
Date:
July 24, 2002

Distributing =

Controlled =

FSub 1 =

State A =

Country B =

Shareholder A =

Shareholder B =

Business X =

Business Y =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

PLR-117209-02

a =

b =

c =

d =

e =

Dear :

This letter responds to your letter dated March 12, 2002, requesting rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated April 17, April 23, May 8, June 24, and July 16, 2002. The information submitted for consideration is summarized below.

Distributing, a State A corporation, is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year basis using an accrual method of accounting. Distributing has one class of voting stock outstanding, which is widely held and publicly traded. On Date 1, the only five-percent shareholders of Distributing were Shareholder A and Shareholder B, both of which are asset management companies that hold the Distributing shares for the benefit of others. To the best of Distributing's knowledge, neither Shareholder A nor Shareholder B holds Distributing common stock for its own account, and no person owning Distributing stock through Shareholder A or Shareholder B holds a 5-percent-or-greater beneficial interest in Distributing common stock. Neither Shareholder A nor Shareholder B participates in the management or operations of Distributing and neither was involved in Distributing's decision to pursue the proposed transaction (described below). Distributing directly, and indirectly through its subsidiaries (including FSub 1), engages in Business X and Business Y.

Distributing formed Controlled, a State A corporation, on Date 2. On Date 3, Distributing contributed Business Y to Controlled in constructive exchange for additional shares of Controlled stock in a transaction intended to qualify under § 351 of the Internal Revenue Code (the "Contribution"). The contribution of one of the Business Y assets was made subject to the consent of the holders of Distributing's outstanding senior notes (the "Senior Notes"). Since Date 3, Distributing has contributed additional Business Y assets to Controlled in constructive exchange for Controlled stock in transactions intended to qualify under § 351 and/or § 368(a)(1)(D). Controlled uses an accrual method of accounting and joins in the consolidated federal income tax return filed by Distributing as the common parent of the affiliated group.

PLR-117209-02

On Date 4, Distributing sold \$a aggregate principal amount of convertible subordinated notes (the "Convertible Notes"). Pursuant to the terms of the Convertible Notes, (i) upon completion of a public offering of Controlled stock Controlled becomes jointly and severally liable for the obligations under the Convertible Notes and (ii) upon completion of a spin-off of Controlled the Convertible Notes become convertible into, in addition to shares of Distributing stock, the same number of shares of Controlled stock that a holder of Convertible Notes would have received if the holder had converted its Convertible Notes immediately prior to the spin-off. Pursuant to an agreement between Distributing and Controlled, as between Distributing and Controlled, Distributing is responsible for all payments on the Convertible Notes (the "Convertible Notes Agreement").

Distributing believes it will enhance the success of Business X and Business Y, and resolve significant internal and external problems that have arisen as a result of, and have been exacerbated by, the operation of Business X and Business Y within a single affiliated group, by effecting a restructuring that will completely separate Business X from Business Y (the "Fit and Focus Purpose").

Moreover, to raise the capital it requires to effect the proposed restructuring, and to fund the operations, capital expenditures, acquisitions and other business needs of Business X after the restructuring, Distributing proposes to effect a public offering of its stock of Controlled. The management of Distributing has concluded that, based upon documentation and analysis provided by an investment banker, an equity offering of Controlled stock with an announced intention to separate Controlled from Distributing will be more cost effective and will raise greater proceeds than an equity offering of Controlled stock without such an announced intention to separate Controlled or an equity offering of Distributing stock (the "Offering Purpose").

To accomplish these objectives, Distributing has proposed, and partially consummated, the following transaction (the "Proposed Transaction"):

- (i) Immediately prior to Date 5, Controlled effected a stock split of its common stock on the basis of e shares for 1.0 share.
- (ii) On Date 5, Distributing sold b shares (representing less than 20 percent) of Controlled stock in an underwritten public offering (the "Offering"). After the Offering, Distributing held and continues to hold shares of Controlled stock representing "control" within the meaning of § 368(c). Distributing used proceeds from the Offering to retire its Senior Notes.
- (iii) As of the effective date of the Offering, Distributing and Controlled entered into various intercompany agreements (the "Intercompany Agreements"). Under one of the Intercompany Agreements, Distributing provided Controlled with working capital financing of up to \$c (the "Loan").

PLR-117209-02

Controlled may draw upon the Loan until Date 6, and all borrowings under the Loan will be repayable on Date 7.

- (iv) As of the effective date of the Offering, Controlled granted options to acquire shares of Controlled stock to employees (including executive officers) and non-management directors of Controlled.
- (v) Within d months of the Offering, Distributing will distribute all of its shares of Controlled stock, pro rata, to Distributing's shareholders (the "Distribution"). Distributing will not distribute fractional share interests of Controlled stock; Distributing shareholders will receive cash in lieu of fractional shares of Controlled stock. In connection with the Distribution, options to acquire shares of Controlled stock may be issued to holders of options to acquire shares of Distributing stock.

Distributing has made the following representations with respect to the Proposed Transaction:

- (a) The indebtedness owed by Controlled to Distributing after the distribution of the Controlled stock will not constitute stock or securities.
- (b) No part of the Controlled stock distributed by Distributing to Distributing's shareholders is being received by any of such shareholders 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 is representative of Distributing's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) The 5 years of financial information submitted on behalf of Controlled is representative of Controlled's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the Proposed Transaction, Distributing and Controlled will each continue the active conduct of their respective businesses, independently and with their separate employees.
- (f) The Distribution is carried out for the following corporate business purposes: the Fit and Focus Purpose; and the Offering Purpose. The Distribution is motivated, in whole or substantial part, by such corporate business purposes.

PLR-117209-02

- (g) 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, Distributing or Controlled after the Proposed Transaction.
- (h) 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 Proposed Transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (i) There is no plan or intention to liquidate either Distributing or Controlled, to merge either Distributing or Controlled with any other corporation, or, except for an intended public offering of FSub1 stock, to sell or otherwise dispose of the assets of Distributing or Controlled after the Proposed Transaction, except in the ordinary course of business.
- (j) Except for the Loan and for obligations for payments under the Intercompany Agreements and the Convertible Notes Agreement, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (k) 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. Further, Distributing's excess loss account with respect to the Controlled stock will be included in income immediately before the Distribution.
- (l) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for approximately fair market value based on terms and conditions arrived at by the parties bargaining at arm's length (except for certain services to be provided by Distributing to Controlled and by Controlled to Distributing, at cost, under the Management Services Agreement).
- (m) No two parties to the Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) 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 either Distributing or

PLR-117209-02

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

- (o) The payment in lieu of fractional shares of Controlled stock 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.
- (p) The gross assets of Business X conducted directly by Distributing 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 Y conducted directly by Controlled 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.

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

- (1) No gain or loss will be recognized by Distributing upon the distribution of all its shares of Controlled in the Distribution (§ 355(c)(1)).
- (2) No gain or loss will be recognized by, and no amount will be included in the income of, the shareholders of Distributing upon the receipt of the Controlled stock (§ 355(a)(1)).
- (3) The aggregate basis of the Distributing stock and the Controlled stock in the hands of the Distributing shareholders immediately after the Distribution will be the same as the aggregate basis of the Distributing stock in the hands of the Distributing shareholders immediately before the Distribution, allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each corporation's stock in accordance with § 1.358-2(a)(2) of the Income Tax Regulations (§§ 358(a)(1), (b), and (c)).
- (4) The holding period of the Controlled stock received by the Distributing shareholders in the Distribution will include the holding period of the Distributing stock held by the Distributing shareholders with respect to which distribution will be made, provided the Distributing shareholders held the Distributing stock as a capital asset on the date of the Distribution (§ 1223(1)).

PLR-117209-02

- (5) Proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(b) and § 1.1502-33.
- (6) Payments made between any of Distributing and Controlled or their subsidiaries and successors under tax sharing agreements between them with respect to tax liabilities that (i) have arisen or will arise for a taxable period ending before the Proposed Transaction and (ii) will not become fixed and ascertainable until after the Proposed Transaction, will be treated as occurring immediately before the Distribution.

We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Internal Revenue Code and regulations or about 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. Specifically, no rulings have been requested and no rulings are issued with respect to the Contribution on Date 3.

The rulings contained in this letter are based upon information 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 material submitted in support of the request for rulings. It is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it 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 transaction covered by this letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to the taxpayer's authorized representative.

Sincerely yours,

Richard E. Coss

Richard E. Coss,
Assistant to the Branch Chief, Branch 3
Office of Associate Chief Counsel (Corporate)

cc: