

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

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Refer Reply To:
CC:CORP:B05
PLR-117996-12

Date:
September 13, 2012

Legend

Parent =

Distributing =

Controlled =

Individual 1 =

Individual 2 =

Individual 3 =

Equity Fund 1 =

Equity Fund 2 =

State A =

Business A =

Business B =

Controlled Debt =

Continuing Arrangements =

a =

b =

c =

d =

e =

f =

g =

h =

i =

Dear _____ :

This letter responds to your letter dated April 25, 2012, and subsequent correspondence, in which you requested rulings regarding certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty 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. In particular, no determination has been made regarding whether the Internal or External Distribution (defined below): (i) satisfies the business purpose requirement of section 1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of Parent, Distributing or Controlled (see section 355(a)(1)(B) of the Internal Revenue Code and Treas. Reg. section 1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest in Parent, Distributing or Controlled (see section 355(e) and Treas. Reg. section 1.355-7).

Summary of Facts

Parent is a State A corporation that is a holding company that uses the accrual method of accounting. Parent is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing is a State A corporation and is an accrual method taxpayer that, at all times relevant to this request, has joined with Parent in filing a consolidated federal income tax return with a calendar year end. Distributing is directly engaged in Business A and Business B. Approximately a percent of Parent's outstanding common stock is held by Individual 1, approximately b percent is held by Individual 2 and approximately c percent is held by Individual 3 (Individual 1, Individual 2 and Individual 3 are the "Shareholders"). Approximately d percent of Parent's outstanding convertible preferred stock ("Preferred Stock") is held by Equity Fund 1 and approximately e percent is held by Equity Fund 2. There are f warrants issued to the holders of Preferred Stock (Equity Fund 1 and 2 are the "Preferred Stock and Warrant Holders").

Parent currently has outstanding stock options issued under its stock option plan. The outstanding options consist of incentive stock options granted to Individual 2 to purchase g shares of Parent common stock (the "Outstanding Options").

Business A has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years. Business B constitutes an expansion of Business A and does not constitute a new or different business.

Proposed Transaction

For what are represented to be valid business purposes, Parent and Distributing propose to undertake the following steps (the "Proposed Transaction"):

- (i) Distributing will form Controlled, a State A corporation.

- (ii) Distributing will contribute the assets and liabilities constituting Business B as currently conducted by Distributing to Controlled in exchange for shares of Controlled common stock, shares of convertible preferred stock and warrants, which will represent 100 percent of the Controlled common and convertible preferred stock and warrants outstanding (the “Contribution”).
- (iii) Distributing and Controlled will execute a debt facility agreement creating the Controlled Debt.
- (iv) Distributing will distribute all its shares of Controlled common and convertible preferred stock and warrants (representing 100 percent of the Controlled common and convertible preferred stock and warrants outstanding) to Parent (the “Internal Distribution”).
- (v) Parent will distribute all of its shares of Controlled common and convertible preferred stock and warrants (representing 100 percent of the Controlled common, convertible preferred stock and warrants outstanding) to the Shareholders and the Preferred Stock and Warrant Holders in identical proportion to their ownership of Parent (the “External Distribution”).
- (vi) The Outstanding Options will be exchanged for new incentive stock options subject to the same terms and vesting schedule as the related Outstanding Options. Individual 2 will surrender his Outstanding Options and receive, in exchange, adjusted stock options in Parent (“New Parent Options”) and Controlled (“New Controlled Options”). The New Parent and New Controlled Options will preserve the economic value of the Outstanding Options. The exercise price of the New Parent Options and the New Controlled Options will bear the same percentage relationship to the market price of Parent and Controlled common stock after the External Distribution as the exercise price of the Outstanding Options bore to the market price of Parent stock before the Proposed Transaction.
- (vii) To accommodate Controlled’s business needs, Individual 1 and Individual 2, both employees of Distributing, will serve as employees for Distributing and Controlled after the External Distribution.
- (viii) To accommodate Controlled’s business needs, three of the five directors for Distributing will also serve as three of the five directors for Controlled (the “Overlapping Directors”). Controlled intends that within h years of the External Distribution, as a result of the addition of new directors, the resignation by Overlapping Directors, the removal of Overlapping Directors from the Controlled board, or other means, the Overlapping Directors will constitute a minority of Controlled’s board of directors.

- (ix) In connection with the Proposed Transaction, Distributing and Controlled will enter into certain agreements concerning continuing business arrangements relating to Business A and Business B (the "Continuing Arrangements"). The Continuing Arrangements are expected to exist for less than i years.

Representations

- (a) Business B is an expansion of Business A, an existing business, as contemplated by Treas. Reg. section 1.355-3(b)(3)(ii).
- (b) None of the Controlled convertible preferred stock will be nonqualified preferred stock within the meaning of section 351(g)(2).
- (c) There are no accumulated but unpaid dividends to the Preferred Stock.
- (d) There is no regulatory, legal, contractual, or economic compulsion or requirement that Distributing fund part or all of the Controlled Debt as a condition of the distribution of Controlled.
- (e) The exercise price of, and the number of Parent shares subject to, the Outstanding Options will be adjusted to reflect the change in value of Parent shares as a result of the Proposed Transaction in a manner that, on a share-by-share basis, (a) preserves the aggregate spread between the exercise price of the Outstanding Options and the fair market value of the underlying Parent stock immediately before the adjustment, and (b) produces a ratio of the exercise price of the New Parent Options and New Controlled Options to the fair market value of the underlying Parent or Controlled stock immediately after the External Distribution that is equal to the ratio of the exercise price of the Outstanding Options to the fair market value of the underlying Parent common stock immediately before the Proposed Transaction.

Contribution and Internal Distribution

- (f) The indebtedness, if any, owed by Controlled to Distributing after the Internal Distribution will not constitute stock or securities.
- (g) No part of the consideration to be distributed by Distributing will be received by Parent as a creditor or in any capacity other than that of a shareholder of Distributing.
- (h) The five years of financial information with regard to Business A and less than five years of financial information with regard to Business B has been submitted on behalf of Distributing and is representative of Distributing's present operations, and with regard to such operations, there have been no

- substantial operational changes since the date of the last financial statements submitted.
- (i) Neither Business A nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Internal Distribution in a transaction in which gain or loss was recognized (or treated as recognized under proposed Treas. Reg. section 1.355-3) in whole or in part. Throughout the five-year period ending on the date of the Internal Distribution, Distributing has been the principal owner of the goodwill and significant assets of Business A and will continue to be the principal owner following the Internal Distribution.
 - (j) Following the Internal Distribution, Distributing will continue the active conduct of Business A, and Controlled will continue the active conduct of Business B, both of which were conducted by Distributing prior to consummation of the Proposed Transaction and independently and with their separate employees (except as provided by the Continuing Arrangements).
 - (k) The Internal Distribution will be carried out for the following corporate business purposes: (i) simplifying and clarifying the operational structure of Business A and Business B, streamlining management, reporting and administration, and achieving strategic coherence; and (ii) using equity incentives to enable Business A and Business B to attract, retain and properly provide incentives to management (the "Corporate Business Purposes"). The distribution of the common stock, convertible preferred stock and warrants of Controlled is motivated, in whole or substantial part, by one or more of these Corporate Business Purposes.
 - (l) The Internal Distribution is not used principally as a device for the distribution of the earnings and profits of Distributing. See section 355(a)(1)(B).
 - (m) For purposes of section 355(d), immediately after the Internal Distribution, no person (determined after applying section 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 section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Internal Distribution.
 - (n) For purposes of section 355(d), immediately after the Internal Distribution, no person (determined after applying section 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 section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of Internal Distribution or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Internal Distribution.
- (o) The Internal Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. section 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
 - (p) No person will hold, immediately after the Internal Distribution, a 50 percent or greater interest in any disqualified investment corporation (as defined in section 355(g)(2)), that such person did not hold before the Internal Distribution (taking into account section 355(g)(3) and (g)(4)).
 - (q) The total adjusted basis and the fair market value of the assets transferred to Controlled in the Contribution will equal or exceed the sum of (i) the total liabilities assumed (within the meaning of section 357(d)) by Controlled, and (ii) the total amount of any money and the fair market value of any other property (within the meaning of section 361(b)) received by Distributing and transferred to its creditors in connection with the reorganization.
 - (r) The liabilities assumed (within the meaning of section 357(d)) by Controlled in the Contribution, if any, and the liabilities to which the transferred assets are subject, if any, were incurred in the ordinary course of business and are associated with the assets being transferred.
 - (s) The total fair market value of the assets transferred by Distributing to Controlled in the Contribution will exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of section 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of cash and the fair market value of any other property (other than stock and securities permitted to be received under section 361(a) without the recognition of gain) received by Distributing in connection with the exchange. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
 - (t) The aggregate fair market value of the assets transferred to Controlled in the

- Contribution will equal or exceed the aggregate adjusted basis of these assets.
- (u) Except for indebtedness that may be created in the ordinary course of business or in connection with the Continuing Arrangements or the Controlled Debt, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Internal Distribution.
 - (v) At the time of the Internal Distribution, Distributing will not have an excess loss account in the Controlled stock.
 - (w) Immediately before the Internal 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. sections 1.1502-13 and 1.1502-14 as in effect before publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; Treas. Reg. section 1.1502-13 as published by T.D. 8597).
 - (x) Payments made in connection with all continuing transactions between Distributing and Controlled, including the Continuing Arrangements, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
 - (y) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
 - (z) Parent, Distributing and Controlled will each pay their own expenses, if any, incurred in connection with the Internal Distribution.

External Distribution

- (aa) The indebtedness, if any, owed by Controlled to Parent after the External Distribution will not constitute stock or securities.
- (bb) Except with respect to New Parent Options and New Controlled Options received in respect to the Outstanding Options, no part of the consideration to be distributed by Parent in the External Distribution will be received by any shareholder of Parent as a creditor, employee, or in any capacity other than that of a shareholder of Parent.
- (cc) Following the External Distribution, Distributing and Controlled will conduct their respective businesses independently with their separate employees, except under the Certain Arrangements where certain employees will be shared on an interim basis. For any employee who is shared by Distributing

- and Controlled, such employee's compensation will be shared by these corporations based upon the amount of time spent in each corporation's respective business, and each corporation will issue a separate Form W-2 to any such employee.
- (dd) The External Distribution will be carried out for the Corporate Business Purposes. The External Distribution is motivated, in whole or substantial part, by one or more of the Corporate Business Purposes.
 - (ee) The External Distribution is not being used principally as a device for the distribution of the earnings and profits of Parent or Controlled. See section 355(a)(1)(B).
 - (ff) For purposes of section 355(d), immediately after the External Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Parent stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the External Distribution.
 - (gg) For purposes of section 355(d), immediately after the External Distribution, no person (determined after applying section 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 section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the External Distribution or (ii) attributable to distributions on Controlled stock or securities that were acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the External Distribution.
 - (hh) The External Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. section 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of section 355(d)(4)) in Controlled (including any predecessor or successor of any such corporation).
 - (ii) Immediately after the External Distribution, neither Parent nor Distributing nor Controlled will be a disqualified investment corporation (within the meaning of section 355(g)(2)).

- (jj) No intercorporate debt will exist between Parent and Controlled at the time of, or subsequent to, the External Distribution.
- (kk) Immediately before the External 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. section 1.1502-13 and 1.1502-14 as in effect before publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; Treas. Reg. section 1.1502-13 as published by T.D. 8597). Further, Distributing's excess loss account with respect to the Controlled Stock, if any, will be included in income immediately before the External Distribution (see Treas. Reg. section 1.1502-19).
- (ll) Payments made in connection with all continuing transactions, if any, between Parent and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (mm) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (nn) Parent, Distributing, Controlled, the Shareholders, and the Preferred Stock and Warrant Holders will each pay their own expenses, if any, incurred in connection with the External Distribution.
- (oo) The income tax liability for the taxable year in which investment credit property (including any building to which section 47(d) applies) is transferred will be adjusted pursuant to section 50(a)(1) or (a)(2) (or section 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.

Rulings

- (1) The Contribution, followed by the Internal Distribution, will qualify as a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be a "party to a reorganization" within the meaning of section 368(b).
- (2) No gain or loss will be recognized by Distributing on the Contribution. Sections 357(a) and 361(a).
- (3) No gain or loss will be recognized by Controlled on the Contribution. Section 1032(a).

- (4) The basis Controlled has in each asset received in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the Contribution. Section 362(b).
- (5) The holding period Controlled has in each asset received in the Contribution will include the period during which Distributing held that asset. Section 1223(2).
- (6) No gain or loss will be recognized by Distributing on the Internal Distribution. Section 361(c).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) Parent upon its receipt of the Controlled stock and securities in the Internal Distribution. Section 355(a)(1).
- (8) No gain will be recognized by Parent on the External Distribution. Section 355(c).
- (9) No gain or loss will be recognized by (and no amount will be included in the income of) the common stock, preferred stock and warrants holders upon their respective receipt of the Controlled stock and securities in the External Distribution. Section 355(a)(1).
- (10) The basis of the Controlled shares and the Distributing shares in the hands of Parent immediately after the Internal Distribution will be the same as the basis in Distributing shares held immediately before the Internal Distribution, allocated in proportion to the fair market value of each in the manner described in Treas. Reg. section 1.358-2(a)(2), section 358(a), (b), and (c); Treas. Reg. section 1.358-1(a).
- (11) The basis of the Controlled shares and the Parent shares in the hands of common stock, preferred stock and warrants holders immediately after the External Distribution will be the same as the basis in Parent shares held immediately before the External Distribution, allocated in proportion to the fair market value of each in the manner described in Treas. Reg. section 1.358-2(a)(2), section 358(a), (b), and (c); Treas. Reg. section 1.358-1(a).
- (12) The holding period of the Controlled common stock received by the respective common stock shareholders in the External Distribution will include the holding period of the Parent stock on which the distribution is made, provided that the Shareholders held such Parent common stock as a capital asset on the date of the External Distribution. Section 1223(1).

- (13) The holding period of the Controlled preferred stock and warrants received by the respective Preferred Stock and Warrant Holders in the External Distribution will include the holding period of the Parent preferred stock and warrants on which the distribution is made, provided that the Shareholders and Preferred Stock and Warrant Holders held such Parent preferred stock or securities as a capital asset on the date of the External Distribution. Section 1223(1).
- (14) Earnings and profits, if any, will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. section 1.312-10(a) and 1.1502-33.
- (15) Earnings and profits, if any, will be allocated between Parent and Controlled in accordance with section 312(h) and Treas. Reg. section 1.312-10(b) and 1.1502-33.

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed regarding:

- (i) The qualification of any options under section 422, including the effect of the proposed amendment to such options, and whether the substitution of Outstanding Options for New Parent Options and New Controlled Options held by an employee of Distributing and Controlled after the External Distribution will constitute a modification, extension or renewal of the options within the meaning of section 424(h);
- (ii) Section 409A;
- (iii) Whether the Controlled Debt is characterized as debt or equity under section 385; and
- (iv) The federal income tax consequences and effects of any transactions consummated under the Continuing Arrangements.

PROCEDURAL STATEMENTS

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, any taxpayer filing its return electronically may satisfy this requirement by

attaching a statement to the return that provides the date and control number of this letter ruling.

In accordance with the power of attorney on file in this office, a copy of this ruling letter will be sent to the taxpayer and other authorized representatives.

Sincerely,

Isaac W. Zimbalist

Isaac W. Zimbalist
Senior Technician Reviewer, Branch 5
Office of Associate Chief Counsel
(Corporate)