

Internal Revenue Service

Department of the Treasury

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Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

LLC =

SpunCo =

Business A =

Business B =

Class C =
Class D =
a =
Date b =
c =
Date d =
Date e =
Date f =
Date g =
Date h =
i =
j =

We reply to your September 17, 1998 request for rulings on certain federal income tax consequences of a proposed transaction.

Summary of Facts

Publicly traded Distributing is the parent of an affiliated group that comprises both domestic and foreign corporations and conducts, among others, Business A and Business B. Distributing joins with its includible affiliates in filing a consolidated federal income tax return. One of these affiliates is wholly owned Sub 1, which is engaged in Business B. Distributing has two classes of common stock outstanding, Class C common (the "Class C Common Stock") and Class D common.

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

On Date b, the Internal Revenue Service issued to Distributing private letter

ruling c in which we concluded that the distribution of SpunCo stock by Distributing to certain of its shareholders would qualify for nonrecognition treatment under § 355 of the Internal Revenue Code (the “Prior Ruling Letter”). The transaction described in the Prior Ruling Letter was completed on Date d.

Approximately a percent of Business B’s current production is used by Distributing in Business A. Business B is attempting to increase its sales to unrelated third parties, but potential customers are reluctant to purchase Business B products while it and Business A are both owned by Distributing.

Proposed Transaction

To eliminate this barrier to the expansion Business B seeks, Distributing has proposed and partially undertaken the following transaction:

- (i) On Date e, Distributing formed wholly owned Sub 2.
- (ii) On Date f, Distributing formed wholly owned Sub 3.
- (iii) On Date g, Distributing formed wholly owned Controlled.

(iv) Distributing will restructure its foreign operations in a series of taxable and nontaxable transactions designed to separate the Business A assets from the Business B assets and position the foreign Business B assets for contribution by Distributing to Sub 2 (the “Restructuring”).

(v) On or about Date h:

(a) Distributing will contribute to Sub 2 the foreign Business B assets (including stock of subsidiaries), including those assets separated in step (iv) above.

(b) Distributing will contribute to Sub 3 certain intellectual property.

(c) Distributing will contribute the stock of Sub 3 to Sub 1, and Sub 1 will contribute certain intellectual property to Sub 3. Sub 3 then will license the intellectual property received from Distributing in the preceding step and from Sub 1 in this step to Distributing on a nonexclusive, royalty-free basis. Certain intellectual property retained by Distributing will be licensed to Sub 3 on similar terms.

(d) Distributing will contribute to newly formed LLC all of the Business B domestic assets (including the stock of Sub 1). Distributing intends that LLC be treated as an unincorporated division of Distributing for federal income tax purposes. See § 301.7701-3 of the Income Tax Regulations.

(e) Distributing will contribute to Controlled the stock of Sub 2 and its membership interest in the LLC in exchange for Controlled stock and the assumption by Controlled of liabilities associated with the contributed assets (the "Contribution").

(vi) Controlled will offer to sell *i* percent of its common stock in an initial public offering (the "IPO").

(vii) Controlled will arrange a commercial bank credit line of approximately *j* dollars. Loan proceeds will be used as working capital, and Controlled will be solely responsible for repayment. No proceeds will be distributed to Distributing.

(viii) Distributing will distribute the Controlled stock it owns to its shareholders through (a) an exchange of Controlled stock for Class C Common Stock ("Split-Off"), (b) a pro rata distribution of Controlled stock on Class C Common Stock ("Spin-Off"), or (c) some combination of (a) and (b) (altogether, the "Distribution"). The means finally selected will depend on market conditions at the relevant time.

Representations

The taxpayers have made the following representations concerning the Contribution and Distribution:

(a) The fair market value of Controlled stock and other consideration received by each holder of Class C Common Stock in a Split-off will approximately equal the fair market value of the Class C Common Stock surrendered by the shareholder in the exchange.

(b) No part of the consideration distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) The five years of financial information submitted on behalf of Distributing represents its present operation, and with regard to Business A and Business B, there have been no substantial operational changes since the date of the last financial statements submitted.

(d) Following the proposed transaction, Distributing and Controlled each will continue the active conduct of its business independently and with its separate employees.

(e) The Distribution will be carried out to increase the amount of business Controlled is able to conduct with unrelated third parties. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(f) There is no plan or intention by any five percent shareholder, and the management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular remaining shareholder or security holder of Distributing, to sell, exchange, transfer by gift or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the Distribution.

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

(h) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the Distribution, except in the ordinary course of business.

(i) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities to be assumed by Controlled plus any liabilities to which the transferred assets are subject.

(j) The liabilities assumed in the transaction 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.

(k) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution, other than payables and receivables arising in the ordinary course of business.

(l) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (see § 1.1502-13 and § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, any excess loss account Distributing may have in the Controlled or Sub 1 stock will be included in income immediately before the Distribution to the extent required by the applicable intercompany transaction regulations (see § 1.1502-19).

(m) Except during a transition period, payments made in all continuing transactions between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arms' length.

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

(o) The Distribution is not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.

(p) The fair market value of licenses granted by Sub 3 to Distributing will approximately equal the fair market value of the licenses granted by Distributing to Sub 3 (see step (v)(c) above).

Rulings

Based on the information submitted and representations made, we rule as follows on the Contribution and 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 (§§ 357(a) and 361(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 will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).

(5) The holding period of each asset received by Controlled 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 (§ 361(c)).

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

(8) For those shareholders of Distributing who surrender all of their Distributing stock for Controlled stock, the basis of the Controlled stock in the hands of each such shareholder will equal the basis of the Distributing stock exchanged therefor (§358(a)).

(9) For those shareholders of Distributing who do not surrender all of their Distributing stock, the aggregate basis of the Distributing stock and the Controlled stock

held by each such shareholder immediately after the Distribution will equal the aggregate basis of such shareholder's Distributing stock held immediately before the Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(b)(2)).

(10) The holding period of Controlled stock received by a Distributing shareholder in a Split-Off will include the holding period of the Distributing stock exchanged therefor, provided the Distributing stock is held as a capital asset on the date of the Split-Off (§ 1223(1)).

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

(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) The transaction described in this ruling letter will not adversely affect the rulings contained in the Prior Ruling Letter.

Caveats

We express no opinion about the tax treatment of this transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings. In particular, we express no opinion regarding the tax treatment of:

- (a) The transition payments referred to above in representation (m);
- (b) The contributions by Distributing to Sub 2, Sub 3, and Sub 1 described above in steps (v)(a),(b), and (c), by Sub 1 to Sub 3 in step (v)(c), and by Distributing to LLC in step (v)(d), including whether the contributions qualify under § 351;
- (c) The cross-licenses described above in step (v)(c);
- (d) The transfer of intellectual property by Distributing and Sub 1 to Sub 3 described above in steps (v)(b) and (c), including whether the intellectual property is "property" under § 351 (see Rev. Rul. 69-156, 1969-1 C.B. 101); and
- (e) The Restructuring described above in step (iv); in particular, whether the Restructuring has international tax implications. See generally §§ 367 and 1248. The Restructuring may be the subject of a separate private letter ruling.

Procedural Statements

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

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

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

Sincerely,

Assistant Chief Counsel (Corporate)

By: *Wayne T. Murray*

Wayne T. Murray
Senior Technician/Reviewer
Branch 4