

**Internal Revenue Service**

Department of the Treasury  
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April 28, 2010

**LEGEND**

Parent =

Distributing =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Controlled =

Exchange =

Industry X =

Business A =

Business B =

Business C =

State A =

State B =

a =

b =

c =

Dear :

This letter responds to your February 18, 2010 request, submitted by your authorized representatives, for rulings on certain federal income tax consequences of the Proposed Transactions (described below). The information provided in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon 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 material 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, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Internal Distribution and the External Distribution (each as defined below): (i) satisfy the business purpose requirement of

Treas. Reg. § 1.355-2(b); (ii) are being used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); or (iii) are 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 the distributing corporation or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7).

## STATEMENT OF FACTS

Parent is a State A holding company and the common parent of an affiliated group of corporations filing a consolidated federal income tax return. Parent has approximately a shares of common stock outstanding, which is publicly traded on the Exchange. It has no other classes of stock and no securities outstanding.

Parent directly owns all of the stock of Distributing, Sub 1, and Sub 2. Distributing is a State A holding company that directly owns all of the stock of Sub 3, Sub 4, Sub 5, and Controlled. Distributing has approximately \$b of notes (the “Notes”) outstanding, which were issued in four separate series. Because the Proposed Transactions will likely result in a change of control and a credit-rating downgrade of Distributing under the terms of the Notes, each Note holder will have the right to require Distributing to repurchase all or any part of such holder’s Note.

Parent, through its separate affiliated group as defined in section 355(b)(3)(B) (the “Parent SAG”), operates three different businesses that are segments of Industry X. Sub 1 and Sub 2 are engaged in Business A. Distributing, through its separate affiliated group as defined in section 355(b)(3)(B) (the “Distributing SAG”), is engaged in Business B. Controlled, a wholly owned subsidiary of Distributing, is engaged in Business C. Financial information has been submitted indicating that each of Business A, Business B, and Business C have had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Because Controlled’s economic model is more closely aligned with that of Business A and its business is largely dedicated to supplying Sub 2 (pursuant to the terms of a comprehensive agreement (the “Controlled Agreement”) entered into by Sub 2, Controlled, and certain state regulatory agencies) there are significant operational and managerial reasons why Parent wants to continue to own and operate Controlled after the Proposed Transactions.

## PROPOSED TRANSACTIONS

For what are represented to be valid business reasons, Parent has proposed the following transactions (the "Proposed Transactions"):

- (i) Parent will issue up to \$ç of new debt.
- (ii) Distributing will merge with and into a newly formed, State B corporation that is wholly owned by Distributing (the "Distributing Reincorporation"). The newly formed, State B corporation will hold no more than a nominal amount of assets prior to the merger. Parent has represented that the Distributing Reincorporation qualifies as a reorganization within the meaning of section 368(a)(1)(F). References to "Distributing" will be to the reincorporated entity unless the context otherwise requires.
- (iii) Distributing will effect a stock split in which each share of Distributing common stock held by Parent will be exchanged at a specified conversion ratio for a greater number of shares, resulting in Parent holding the same number of shares of Distributing stock immediately prior to the External Distribution as the number of outstanding shares of Parent stock at that time (the "Distributing Recapitalization"). In connection with the Distributing Recapitalization, cash will be distributed for any fractional share of Distributing stock. Parent has represented that the Distributing Recapitalization qualifies as a reorganization within the meaning of section 368(a)(1)(E).
- (iv) Distributing will distribute all of its Controlled stock to Parent (the "Internal Distribution").
- (v) Parent will transfer up to \$ç of cash to Distributing (the "Contribution") in order to establish the appropriate capital structure for Distributing and to assist Distributing in satisfying its repurchase obligations under the Notes.
- (vi) Parent will distribute all of its Distributing stock to Parent's shareholders (the "External Distribution").

Because of differing retirement benefits, certain employees who perform services at Controlled are employed by a subsidiary of Distributing. In connection with the Proposed Transactions, these employees will be transferred to Controlled or an indirect subsidiary of Parent.

Pursuant to the Controlled Agreement, Sub 2 owns certain economic interests with respect to real property governed by the Controlled Agreement, while Controlled owns all other interests and rights with respect to the property. Notwithstanding that title to

the real property is held by Sub 3, Parent has consistently operated the property in accordance with the terms and conditions of the Controlled Agreement and the ownership rights described above, and for tax purposes, has treated Sub 2 as owning an economic interest in the property and Controlled as holding beneficial ownership of all other interests and rights with respect to the property since the execution of the Controlled Agreement. Parent intends to correct the title to Controlled's interests and rights in the real property, but any action taken will not affect how ownership of the interests and rights is reported for tax purposes.

Following the Proposed Transactions, Parent, Distributing, Controlled, and their subsidiaries will continue to provide certain operating services to other members of the Parent group and the Distributing group that are now being provided between the companies under existing contracts. All such services will be provided pursuant to arm's length contracts. In addition, in connection with the Proposed Transactions, Distributing anticipates entering into a tax sharing agreement and a transition services agreement with Parent and its subsidiaries.

Further, to reassure investors and facilitate a smooth transition following the Proposed Transactions, Parent and Distributing may share a common chairman of the board for a period of time. At a minimum, Parent expects the chairman's term to be consistent with the guidance provided in Rev. Rul. 2003-74, 2003-2 C.B. 77.

## **REPRESENTATIONS**

### Internal Distribution

The following representations are made regarding the Internal Distribution:

- (1a) No part of the consideration to be 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.
- (1b) The five years of financial information submitted on behalf of Business B conducted by the Distributing SAG is representative of the present operations of the business, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (1c) The five years of financial information submitted on behalf of Business C conducted by Controlled is representative of the present operations of the business, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

- (1d) The Distributing SAG neither acquired Business B nor acquired control of an entity conducting Business B 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) in whole or in part, excluding in each case acquisitions that constitute expansions, as contemplated by Treas. Reg. § 1.355-3(b)(3)(ii), of Business B. Throughout the five-year period ending on the date of the Internal Distribution, the Distributing SAG will have been the principal owner of the goodwill and significant assets of Business B and it will continue to be the principal owner following the Internal Distribution.
- (1e) Controlled neither acquired Business C nor acquired control of an entity conducting Business C 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) in whole or in part. Throughout the five-year period ending on the date of the Internal Distribution, Controlled will have been the principal owner of the goodwill and significant assets of Business C and it will continue to be the principal owner following the Internal Distribution.
- (1f) Following the Internal Distribution, the Distributing SAG and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (1g) The Internal Distribution is carried out for the following corporate business purposes: to facilitate the External Distribution. The Internal Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (1h) The Internal Distribution is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (1i) 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.
- (1j) 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 the Internal Distribution, or (ii) attributable to distributions on Distributing stock 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.
- (1k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Internal Distribution.
  - (1l) 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. §§ 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).
  - (1m) Immediately before the Internal Distribution, Distributing will not have an excess loss account (within the meaning of Treas. Reg. § 1.1502-19(a)(2)) in Controlled's stock.
  - (1n) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
  - (1o) No two parties to the Internal Distribution are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
  - (1p) The Internal Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 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).
  - (1q) Immediately after the Internal Distribution, either (1) no person will hold a 50-percent or greater interest (within the meaning of section 355(g)(3)) in the stock of Distributing or Controlled who did not hold such an investment immediately before the transaction, or (2) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of section 355(g)(2)).
  - (1r) There is no regulatory, legal, contractual, or economic compulsion or requirement that the Contribution be made as a condition of the Internal Distribution. The fact that the value of Distributing will decrease as a result of

the Internal Distribution was not a consideration in the decision to contribute property to Distributing. The Internal Distribution is not contingent on there being contributed to Distributing assets having a specified (or a roughly specified) value.

### Contribution and External Distribution

The following representations are made regarding the Contribution and External Distribution:

- (2a) No part of the consideration to be distributed by Parent will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Parent.
- (2b) The five years of financial information submitted on behalf of Business A conducted by the Parent SAG is representative of the present operations of the business, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (2c) The five years of financial information submitted on behalf of Business B conducted by the Distributing SAG is representative of the present operations of the business, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (2d) The Parent SAG neither acquired Business A nor acquired control of an entity conducting Business A during the five-year period ending on the date of the External Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the External Distribution, the Parent SAG will have been the principal owner of the goodwill and significant assets of Business A and it will continue to be the principal owner following the External Distribution.
- (2e) The Distributing SAG neither acquired Business B nor acquired control of an entity conducting Business B during the five-year period ending on the date of the External Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part, excluding in each case acquisitions that constitute expansions, as contemplated by Treas. Reg. § 1.355-3(b)(3)(ii), of Business B. Throughout the five-year period ending on the date of the External Distribution, the Distributing SAG will have been the principal owner of the goodwill and significant assets of Business B and it will continue to be the principal owner following the External Distribution.



- (2f) Following the External Distribution, the Parent SAG and the Distributing SAG will each continue the active conduct of its business, independently and with its separate employees.
- (2g) The External Distribution is carried out for the following corporate business purposes: (1) to facilitate equity and debt financing by Distributing to capitalize on a number of significant growth opportunities available to Business B, and (2) to improve the fit and focus of Business A and Business B by resolving inherent internal managerial and operational conflicts. The External Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (2h) The External Distribution is not used principally as a device for the distribution of the earnings and profits of Parent or Distributing or both.
- (2i) 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 Parent 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.
- (2j) 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 Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing 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 Parent stock 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.
- (2k) The total adjusted basis of the assets that will be transferred to Distributing in the Contribution will equal or exceed the sum of (i) the total liabilities assumed (within the meaning of section 357(d)) by Distributing 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 Parent from Distributing and transferred to Parent's shareholders or creditors pursuant to the plan of reorganization.

- (2l) The total fair market value of the assets transferred to Distributing in the Contribution will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of section 357(d)) by Distributing in the Contribution and External Distribution, (ii) the amount of any liabilities owed to Distributing by Parent that are discharged or extinguished in the Contribution and External Distribution, and (iii) the amount of any 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 Parent in the Contribution and External Distribution. The fair market value of the assets of Distributing will exceed the amount of its liabilities immediately after the exchange.
- (2m) Any liabilities assumed (within the meaning of section 357(d)) by Distributing in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- (2n) No intercorporate debt will exist between Parent and Distributing at the time of, or subsequent to, the External Distribution.
- (2o) 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. §§ 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, Parent's excess loss account, if any, with respect to the Distributing stock will be included in income immediately before the External Distribution (see Treas. Reg. § 1.1502-19).
- (2p) Payments made in connection with all continuing transactions, if any, between Parent and Distributing will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (2q) No two parties to the External Distribution are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (2r) The External Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 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 Parent or Distributing (including any predecessor or successor of any such corporation).
- (2s) Immediately after the External Distribution either (1) no person will hold a 50-percent or greater interest (within the meaning of section 355(g)(3)) in the stock of Parent or Distributing who did not hold such an investment

immediately before the transaction, or (2) neither Parent nor Distributing will be a disqualified investment corporation (within the meaning of section 355(g)(2)).

## **RULINGS**

### Internal Distribution

Based solely on the information and representations submitted, we rule as follows on the Internal Distribution:

- (1) No gain or loss will be recognized by Distributing on its distribution of the Controlled stock in the Internal Distribution (section 355(c)).
- (2) 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 in the Internal Distribution (section 355(a)(1)).
- (3) The aggregate basis of the Distributing stock and the Controlled stock in the hands of Parent immediately after the Internal Distribution will be the same as the basis of the Distributing stock in the hands of Parent immediately before the Internal Distribution (section 358(a) and Treas. Reg. § 1.358-1(a)). Such basis will be allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a)(2) (section 358(b)(2) and (c)).
- (4) The holding period of the Controlled stock received by Parent in the Internal Distribution will include the holding period of the Distributing stock with respect to which the Internal Distribution will be made, provided that such Distributing stock is held as a capital asset on the date of the Internal Distribution (section 1223(1)).
- (5) Earnings and profits will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. §§ 1.312-10(b) and 1.1502-33(f)(2).

### Contribution and External Distribution

Based solely on the information and representations submitted, we rule as follows on the Contribution and External Distribution:

- (6) The Contribution, together with the External Distribution, will constitute a reorganization under section 368(a)(1)(D). Parent and Distributing will each be “a party to a reorganization” under section 368(b).

- (7) No gain or loss will be recognized by Parent on the Contribution (section 361(a)).
- (8) No gain or loss will be recognized by Distributing on the Contribution (section 1032(a)).
- (9) No gain or loss will be recognized by Parent on the External Distribution (section 361(c)(1)).
- (10) No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Parent upon the receipt of the Distributing stock in the External Distribution (section 355(a)(1)).
- (11) The aggregate basis of the Parent stock and the Distributing stock in the hands of each Parent shareholder immediately after the External Distribution will be the same as the basis of the Parent stock in the hands of such Parent shareholder immediately before the External Distribution (section 358(a) and Treas. Reg. § 1.358-1(a)). Such basis will be allocated between the Parent stock and the Distributing stock in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a)(2) (section 358(b)(2) and (c)). If a Parent shareholder that purchased or acquired shares of Parent stock on different dates or at different prices is not able to identify which particular share of Distributing stock (or portion thereof) is received with respect to a particular share of Parent stock, the shareholder may designate which share of Distributing stock is received with respect to a particular share of Parent stock, provided the terms of the designation are consistent with the terms of the External Distribution (Treas. Reg. § 1.358-2(a)(2)(vii)).
- (12) The holding period of the Distributing stock received by Parent shareholders in the External Distribution will include the holding period of the Parent stock with respect to which the External Distribution will be made, provided that such Parent stock is held as a capital asset on the date of the External Distribution (section 1223(1)).
- (13) Earnings and profits will be allocated between Parent and Distributing in accordance with section 312(h) and Treas. Reg. §§ 1.312-10(a) and 1.1502-33(e)(3).

### **CAVEATS**

Except as expressly provided herein, no opinion is expressed or implied concerning the tax treatment of the Proposed Transactions under other provisions of the Code or the regulations, or the tax treatment of any conditions existing at the time of, or effects

resulting from, the Proposed Transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

- (i) Whether the Internal Distribution and the External Distribution satisfy the business purpose requirement of Treas. Reg. § 1.355-2(b);
- (ii) Whether the Internal Distribution and the External Distribution will be used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both; and
- (iii) Whether the Internal Distribution and the External Distribution will be part of a plan (or series of related transactions) under section 355(e)(2)(A)(ii).

### **PROCEDURAL STATEMENTS**

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Frances L. Kelly  
Assistant to the Branch Chief, Branch 2  
Office of Associate Chief Counsel (Corporate)

cc: