

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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Refer Reply To:
CC:CORP:3 - PLR-105060-00
Date:
September 21, 2000

In re:

Distributing =

Business A =

Business B =

Date C =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

PLR-105060-00

Sub 7 =

Controlled =

State X =

State Y =

Financial Advisor =

K =

L =

M =

N =

P =

This letter responds to a letter dated March 1, 2000, in which rulings are requested regarding certain federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated July 18 and August 8, 2000. The information submitted for consideration is summarized below.

Distributing, a State X corporation, is engaged, directly and through domestic and foreign affiliates, primarily in two general lines of business: Business A (including the "A segment" and the "A-1 segment") and Business B (including the "B segment" and the "B-1 segment"). Distributing has a single class of voting common stock outstanding.

Sub 1, Sub 2, Sub 3, Sub 4, and Sub 5, all State X corporations, are all engaged in Business A. Sub 1, Sub 2 and Sub 3 are engaged in the A segment of Business A. Sub 4 is engaged in the A-1 segment of Business A. All of the outstanding stock of each of Sub 1, Sub 2, Sub 3, Sub 4 and Sub 5 has been held by Distributing for at least 5 years.

Sub 6 and Sub 7, both State X corporations, are engaged in the B segment and the B-1 segment, respectively, of Business B. All of the outstanding stock of each of Sub 6 and Sub 7 has been held by Distributing for at least 5 years.

PLR-105060-00

Controlled will be a State X corporation formed by Distributing in connection with the proposed transaction. Controlled will have a single class of voting common stock outstanding.

Financial information has been submitted 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 five years.

Business B is a dynamic, growing business that has considerable capital requirements. Business B receives over three-quarters of Distributing's annual capital expenditures; these expenditures are devoted primarily to product creation. To exploit emerging Internet opportunities, Business B will require spending in excess of historic levels.

Currently, Distributing has limited capacity to raise capital in the debt market due to its high leverage ratio. Management, along with Financial Advisor, have determined that the best method to raise capital in the near term is through an initial public offering ("IPO") of the stock of Controlled, which will conduct Business B. Distributing has been advised by Financial Advisor that an IPO will be materially more successful if it is undertaken in conjunction with the pre-announced separation of Business B from Distributing, which is to occur shortly after the IPO, and that an IPO of Controlled stock would be less successful if Controlled remained a Distributing subsidiary. Financial Advisor has advised Distributing that, based on past experience, Distributing's continued ownership would have a detrimental impact on the IPO price for Controlled stock. Accordingly, the following transaction is proposed:

- (i) Distributing will organize Controlled, a domestic corporation, as a wholly owned subsidiary.
- (ii) Miscellaneous foreign assets relating to Business B but now held by companies that are engaged primarily in Business A will be transferred to foreign subsidiaries engaged in Business B.
- (iii) Sub 3 will transfer (a) its K division to a newly formed domestic wholly owned subsidiary, and (b) all of its other assets, subject to liabilities, to a newly formed, wholly owned domestic limited liability company ("Sub 3 LLC).
- (iv) Sub 3 will merge with and into Distributing pursuant to the relevant statutory merger provisions of state law.
- (v) The L manufacturing operations of Sub 1 conducted in State Y (the "LY operations") and the assets and liabilities of the M divisions of Sub 4 will be transferred to Sub 3 LLC.

PLR-105060-00

- (vi) Distributing will transfer to Controlled all of the assets related to Business B, including the stock of Sub 6 and Sub 7, in exchange for all of the stock of Controlled and the assumption by Controlled of liabilities of Business B, including an appropriate portion of the amount outstanding on Distributing's revolving debt facility (the "Contribution"). The assumption of a portion of the revolving debt facility will be accomplished immediately prior to the spinoff by Distributing borrowing the appropriate amount pursuant to a new revolving credit agreement that will be specifically assumable, and will be assumed, by Controlled (the "Assumed Revolver"). Distributing will use the net proceeds of the Assumed Revolver to pay down its existing revolving credit facility.
- (vii) Controlled will contribute miscellaneous subsidiaries and other assets to Sub 6 and Sub 7.
- (viii) Controlled will sell in the IPO newly issued shares of its stock amounting to approximately (but somewhat less than) 20 percent of its outstanding stock immediately after the IPO. Controlled will contribute or lend the net proceeds of the IPO to Sub 6 and Sub 7 to enable Sub 6 and Sub 7 to repay a portion of their preexisting intercompany indebtedness owed to Distributing.
- (ix) With the exception of certain financing arrangements that will remain in existence between Sub 7 and Sub 5, all remaining intercompany indebtedness, if any, between companies that will be members of different public groups following the spinoff will be eliminated through dividends, capital contributions, or payments, as appropriate, in order that there will not be any indebtedness between such companies following the proposed transactions.
- (x) Controlled will borrow funds pursuant to a new revolving credit agreement (to be combined with the Assumed Revolver) and will lend or contribute the borrowed funds to Sub 6 and Sub 7 to enable Sub 6 and Sub 7 to repay the remainder of their preexisting intercompany indebtedness owed to Distributing.
- (xi) Distributing will distribute all of its shares of Controlled to the shareholders of Distributing on a pro rata basis (the "Distribution"). It is intended that Distributing distribute the Controlled stock it owns to its shareholders as soon as possible after the IPO (but no later than six months after the IPO). No fractional shares of Controlled stock will be issued. In lieu thereof, Distributing will distribute cash or the distribution agent will

PLR-105060-00

aggregate all fractional share interests, sell the shares, and remit the proceeds to the shareholders entitled thereto.

Following the proposed transaction, Distributing and its affiliates will conduct Business A, and Controlled and its affiliates will conduct Business B.

The taxpayers have made the following representations in connection with the Contribution:

- (a) No stock or securities will be issued for services rendered to or for the benefit of Controlled in connection with the transaction; and no stock or securities will be issued for indebtedness of Controlled or for interest on indebtedness of Controlled that is not evidenced by a security or for interest on indebtedness of Controlled accrued on or after the beginning of the holding period of Distributing for the debt.
- (b) None of the stock to be transferred is "section 306 stock" within the meaning of § 306(c).
- (c) The Contribution is not the result of a solicitation by a promoter, broker, or investment house.
- (d) Distributing will not retain any rights in the property transferred to Controlled.
- (e) The total adjusted basis and the fair market value of the property to be transferred to Controlled by Distributing in the Contribution will, in each case, equal or exceed the sum of the liabilities assumed (as determined under § 357(d)) by Controlled.
- (f) The liabilities assumed (as determined under § 357(d)) in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- (g) There is no indebtedness between Distributing and Controlled, and no indebtedness will be created in favor of Distributing in exchange for the transferred property as a result of the proposed transaction.
- (h) All transfers and exchanges in connection with the Contribution will occur pursuant to a plan that will be agreed on before the transaction and in which the rights of the parties will be defined.
- (i) All exchanges that are part of the Contribution will occur on approximately the same date.

PLR-105060-00

- (j) There is no plan or intention on the part of Controlled to redeem or otherwise acquire any stock or indebtedness to be issued in the Contribution.
- (k) Taking into account any issuance of additional shares of Controlled common stock; any issuance of stock for services; the exercise of any Controlled stock rights, warrants, or subscriptions; a public offering of Controlled stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of Controlled to be received in the Contribution, the shareholders of Distributing will be in "control" of Controlled within the meaning of § 368(c) of the Code.
- (l) Distributing will receive stock of Controlled equal to the fair market value of the property transferred to Controlled in exchange therefor.
- (m) Controlled will remain in existence on the day of and after the transaction and will continue to hold, directly and indirectly, the property transferred in the Contribution.
- (n) Except for transfers of property to Sub 6 and Sub 7, as described in step (vii), above, there is no plan or intention by Controlled to dispose of the transferred property, other than in the normal course of business.
- (o) Distributing and Controlled will each pay its own expenses, if any, incurred in connection with the Contribution.
- (p) Controlled will not be an investment company within the meaning of § 351(e)(1) and § 1.351-1(c)(1)(ii).
- (q) Distributing is not under the jurisdiction of a court in a Title 11 or similar case (within the meaning of § 368(a)(3)(A)) and the stock or securities received in the exchange will not be used to satisfy indebtedness of Distributing.
- (r) Controlled will not be a "personal service corporation" within the meaning of § 269A.

The taxpayers have made the following representations in connection with the Distribution:

- (s) Any indebtedness owed by Controlled to Distributing or any other related party after the Distribution will not constitute stock or securities for federal income tax purposes.
- (t) 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.

PLR-105060-00

- (u) The five years of financial information submitted on behalf of each of Sub 3, the LY operations, the M division of Sub 4, Sub 6, and Sub 7 is representative of its present operations and, with regard to each of these businesses, there have been no substantial operational changes since the date of the last financial statements submitted.
- (v) Immediately following the transaction, Distributing will actively conduct the former business of Sub 3, the LY operations, and the operations of the M divisions of Sub 4 essentially as those businesses were conducted by Sub 3, Sub 1, and Sub 4, respectively.
- (w) Immediately following the Distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of the stock and securities of Sub 6 and Sub 7, controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (x) Following the Distribution, Sub 6 and Sub 7 will each continue the active conduct of its respective business, independently and with employees of the affiliated group.
- (y) The Distribution is being undertaken for the business purpose described above. The distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (z) 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 the best of its knowledge, is not aware of any plan or intention on the part of any particular remaining shareholder of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the Distribution.
- (aa) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (bb) 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 any of the assets of these corporations subsequent to the Distribution, except in the ordinary course of business.
- (cc) No indebtedness will exist between Distributing and Controlled at the time or, or subsequent to the Distribution. However, certain financing arrangements will remain in existence between Sub 7 and Sub 5.

PLR-105060-00

- (dd) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany 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, Distributing's excess loss account, if any, with respect to the Controlled common 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).
- (ee) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value and based on terms and conditions arrived at by the parties bargaining at arms' length.
- (ff) No two parties to the proposed transaction are investment companies as defined in §§ 368(a)(2)(F)(iii) and (iv).
- (gg) 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.

Based solely on the information submitted and on the representations set forth above, it is held as follows:

(1) No gain or loss will be recognized by Distributing on the Contribution (§§ 351(a) and 357(a)).

(2) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).

(3) The basis of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(a)(1)).

(4) The holding period of each asset received by Controlled in the Contribution will include the holding period of that asset in the hands of Distributing (§ 1223(2)).

(5) No gain or loss will be recognized by Distributing upon the distribution of its Controlled stock (§ 355(c)).

(6) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders on their receipt of the Controlled stock (§ 355(a)(1)).

PLR-105060-00

(7) The aggregate basis of the Distributing stock and the Controlled stock in the hands of the Distributing shareholders after the Distribution will be the same as the aggregate basis of the 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(a), (b), and (c)).

(8) The holding period of the Controlled stock in the hands of the Distributing shareholders will include the period for which such shareholder held the Distributing stock with respect to which the Distribution will be made, provided that such stock was held as a capital asset by such shareholder on the date of distribution (§ 1223(1)).

(9) Proper allocation of earnings and profits between Distributing and Controlled will be made under §§ 1.312-10(b) and 1.1502-33.

(10) If cash is received by a Distributing shareholder in lieu of a fractional share of stock of Controlled, gain or loss will be recognized by the shareholder measured by the difference between the basis of the fractional share interest, as determined in ruling (7) above, and the amount of cash received. If the fractional share qualifies as a capital asset in the hands of the shareholder, the gain or loss will be a capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code (sections 1221 and 1222).

No opinion is expressed about the tax treatment of steps (ii), (iii) (iv), (v), (vii), (viii), (ix), and (x), above. In addition, no opinion is expressed about the tax effects, if any, of the transfers in step (ii) on the above rulings, or about the proposed 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.

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

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

Sincerely yours,
Associate Chief Counsel (Corporate)

By Michael J. Wilder

Michael J. Wilder
Assistant to the Chief, Branch 3