

Internal Revenue Service

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Washington, DC 20224

Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:B04

PLR-134993-06

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Legend

Distributing 2 =

Distributing 1 =

Controlled 1 =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

Sub 7 =

Sub 8 =

Sub 9 =

Sub 10 =

Sub 11 =

Sub 12 =

Sub 13 =

Sub 14 =

A =
B =
C =
D =
E =
Business X =
Business Y =
Asset Z =
a =
b =
c =
d =
e =

Dear _____ :

This letter responds to your July 14, 2006 letter requesting rulings as to certain federal income tax consequences of a proposed transaction. The information submitted in that letter and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayers and accompanied by penalty of perjury statements executed by the appropriate parties. 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.

Moreover, no determination has been made regarding whether the Internal Spin-Off and the External Spin-Off (both defined below): (i) satisfy the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, (ii) are being used principally as a device for the distribution of the earnings and profits of Distributing 2, Distributing 1, or Controlled 1 (see § 355(a)(1)(B) of the Internal Revenue Code and

§ 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 Distributing 2, Distributing 1, or Controlled 1 (see § 355(e) and § 1.355-7).

Summary of Facts

Distributing 2 is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing 2 has a single class of voting common stock outstanding (the "Distributing 2 Common Stock"), and A, B, C, D, and E each own more than five percent of the Distributing 2 Common Stock. Distributing 2 engages in Business X and Business Y through its domestic and foreign subsidiaries.

Distributing 2 wholly owns Distributing 1. Distributing 1 wholly owns each of Sub 1, Sub 2, Sub 4, Sub 5, Sub 6, Sub 7, Sub 8, Sub 9, and Controlled 1. Distributing 1 owns a percent of Sub 3, while the remainder of Sub 3 is owned by independent third parties. Distributing 1 also owns b percent of Sub 10 (a partnership), and Sub 1 owns the remaining c percent of Sub 10. Sub 6 wholly owns Sub 11, and Sub 11 owns all of Sub 12 (a limited liability company disregarded as separate from its owner for federal income tax purposes). Controlled 1 wholly owns Sub 13, and Sub 13 wholly owns Sub 14. All of the above-described entities are domestic.

Financial information has been submitted which indicates that Business X (as conducted by Sub 1) and Business Y (as conducted by Sub 14) each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

For what are represented to be valid business reasons, the following series of transactions have been proposed (collectively, the "Proposed Transaction"):

Proposed Transaction

- (i) The stock of Distributing 2 will undergo a reverse split. Although subject to change, the current plan is that each d shares of Distributing 2 Common Stock will be exchanged for one share of Distributing 2 Common Stock. Cash will be distributed in lieu of fractional shares of Distributing 2 stock. In addition, Distributing 2 will authorize the issuance of additional Distributing 1 stock so that the same number of Distributing 1 and Distributing 2 shares are outstanding.
- (ii) Sub 12 will distribute Asset Z to Sub 11. Sub 11 will subsequently distribute Asset Z to Sub 6. Sub 6 will subsequently distribute Asset Z to Distributing 1. Finally, Distributing 1 will contribute Asset Z to Sub 1.
- (iii) Sub 1 will distribute its c percent partnership interest in Sub 10 to Distributing 1.

- (iv) Distributing 1 will contribute its interest in Sub 2, Sub 3, Sub 4, Sub 5, Sub 6, Sub 7, Sub 8, Sub 9, and Sub 10 to Controlled 1 (the "Contribution").
- (v) Distributing 1 will borrow \$e dollars from third party lenders and will distribute such amount to Distributing 2 (the "Cash Distribution"). The Cash Distribution will not exceed Distributing 2's basis in Distributing 1. Distributing 2 will use all of the proceeds of the Cash Distribution to retire its pre-existing debts.
- (vi) Immediately after the Cash Distribution, Distributing 1 will distribute all of the Controlled 1 stock to Distributing 2 (the "Internal Spin-Off").
- (vii) Distributing 2 will then distribute all of the Distributing 1 stock pro rata to its shareholders (the "External Spin-Off").

Following the External Spin-Off, Distributing 2 will provide certain transitional services to Distributing 1 and Sub 1 pursuant to a transition service agreement (the "Transition Service Agreement").

Representations

The following representations have been made with respect to the Contribution and the Internal Spin-Off:

- (a) No intercorporate debt will exist between Distributing 1 and Controlled 1 at the time of, or subsequent to, the Internal Spin-Off other than any indebtedness that may arise in connection with the Transition Service Agreement.
- (b) The indebtedness, if any, owed by Controlled 1 to Distributing 1 after the Internal Spin-Off will not constitute stock or securities.
- (c) No part of the consideration to be distributed in the Internal Spin-Off will be received by Distributing 2 as a creditor, employee, or in any capacity other than that of a shareholder of Distributing 1.
- (d) Distributing 2 will elect not to apply the transitional rule of § 355(b)(3)(C). Therefore, Distributing 2, Distributing 1, and Controlled 1 will treat all members of their respective separate affiliated group as defined in § 355(b)(3)(B) (hereinafter, "SAG") as one corporation in determining whether it meets the requirements of § 355(b)(2)(A) regarding the active conduct of a trade or business.
- (e) The five years of financial information submitted on behalf of the business conducted by Sub 1 (a member of Distributing 1's SAG immediately before and after the Internal Spin-Off) is representative of the present business operations of Sub 1, and

with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

(f) The five years of financial information submitted on behalf of the business conducted by Sub 14 (a member of Distributing 2's and Controlled 1's SAG immediately before and after the Internal Spin-Off) is representative of the present business operations of Sub 14, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

(g) Following the Internal Spin-Off, Sub 1 and Sub 14 will each continue the active conduct of its respective business, independently and with its own employees, except with respect to the Transition Service Agreement. Pursuant to the Transition Service Agreement, Distributing 2 will continue to provide tax, finance, human resource, facilities and property management, and legal services to Sub 1 at arms-length pricing.

(h) The Internal Spin-Off will be carried out to facilitate the External Spin-Off, which will be carried out for the following corporate business purposes: to facilitate the raising of capital through a stock offering of Distributing 1, the use of Distributing 1 stock as acquisition currency, and the use of Distributing 2 and Distributing 1 stock as employee compensation.

(i) The Internal Spin-Off is not being used principally as a device for the distribution of the earnings and profits of Distributing 1 or Controlled 1 or both.

(j) The total adjusted basis and the fair market value of the assets transferred to Controlled 1 by Distributing 1 in the Contribution each equals or exceeds the sum of the liabilities assumed (within the meaning of § 357(d)) by Controlled 1 plus any liabilities to which the transferred assets are subject.

(k) The total fair market value of the assets that Distributing 1 will transfer to Controlled 1 in the Contribution will exceed the sum of: (a) the amount of liabilities (if any) assumed (within the meaning of § 357(d)) by Controlled 1 in connection with the exchange, (b) the amount of liabilities (if any) owed to Controlled 1 by Distributing 1 that are discharged or extinguished in connection with the exchange, and (c) the amount of cash and the fair market value of the property (if any) (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing 1 from Controlled 1 in connection with the exchange. The fair market value of the assets of Controlled 1 will exceed the amount of its liabilities immediately after the exchange.

(l) The total fair market value of the assets transferred to Controlled 1 by Distributing 1 in the Contribution will equal or exceed the aggregate adjusted basis of the transferred assets.

(m) The liabilities assumed (within the meaning of § 357(d)) by Controlled 1 in the Contribution 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.

(n) Immediately before the Internal Spin-Off, 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).

(o) Payments made in connection with continuing transactions between Controlled 1 and Distributing 1 will be for fair market value based on terms and conditions arrived at by parties bargaining at arm's length.

(p) Neither Controlled 1 nor Distributing 1 is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).

(q) For purposes of § 355(d), immediately after the Internal Spin-Off, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing 1 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing 1 stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(r) For purposes of § 355(d), immediately after the Internal Spin-Off, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled 1 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled 1 stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Internal Spin-Off or (ii) attributable to distributions on Controlled 1 stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Internal Spin-Off.

(s) The Internal Spin-Off 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 1 or Controlled 1, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing 1 or Controlled 1.

The following representations have been made with respect to the External Spin-Off:

(t) No intercorporate debt will exist between Distributing 2 and Distributing 1 at the time of, or subsequent to, the External Spin-Off, other than any indebtedness that may arise in connection with the Transition Service Agreement.

(u) The indebtedness, if any, owed by Distributing 1 to Distributing 2 after the External Spin-Off will not constitute stock or securities.

(v) No part of the consideration to be distributed by Distributing 2 in the External Spin-Off will be received by a shareholder of Distributing 2 as a creditor, employee, or in any capacity other than that of a shareholder of Distributing 2.

(w) The five years of financial information submitted on behalf of the business conducted by Sub 14 (a member of Distributing 2's SAG) is representative of the present business operations of Sub 14, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

(x) The five years of financial information submitted on behalf of the business conducted by Sub 1 (a member of Distributing 1's SAG immediately before and after the External Spin-Off) is representative of the present business operations of Sub 1, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

(y) Following the External Spin-Off, Sub 1 and Sub 14 will each continue the active conduct of its respective business, independently and with its own employees, except with respect to the Transition Service Agreement. Pursuant to the Transition Service Agreement, Distributing 2 will continue to provide tax, finance, human resource, facilities and property management, and legal services to Distributing 1 and Sub 1 at arms-length pricing.

(z) The External Spin-Off is to be carried out for the following corporate business purposes: to facilitate the raising of capital through a stock offering of Distributing 1, the use of Distributing 1 stock as acquisition currency, and the use of Distributing 2 and Distributing 1 stock as employee compensation.

(aa) The External Spin-Off is not being used principally as a device for the distribution of the earnings and profits of Distributing 2 or Distributing 1 or both.

(bb) Immediately before the External Spin-Off, 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, Distributing 2's excess loss account (if any) with respect to the stock of Distributing 1 will be included in income immediately before the External Spin-Off (see §1.1502-19).

(cc) Payments made in connection with continuing transactions between Distributing 1 and Distributing 2, and between Sub 1 and Distributing 2, will be for fair market value based on terms and conditions arrived at by parties bargaining at arm's length.

(dd) Neither Distributing 2 nor Distributing 1 is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).

(ee) For purposes of § 355(d), immediately after the External Spin-Off, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing 2 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing 2 stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the External Spin-Off.

(ff) For purposes of § 355(d), immediately after the External Spin-Off, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing 1 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing 1 stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the External Spin-Off or (ii) attributable to distributions on Distributing 2 stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the External Spin-Off.

(gg) The External Spin-Off 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 2 or Distributing 1 entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing 2 or Distributing 1.

Rulings

Based solely on the information and representations submitted, we rule as follows regarding the Contribution, the Internal Spin-Off, and the Cash Distribution:

(1) The Contribution, together with the Internal Spin-Off, will be a reorganization under § 368(a)(1)(D). Distributing 1 and Controlled 1 will each be "a party to a reorganization" under § 368(b).

(2) No gain or loss will be recognized by Distributing 1 in the Contribution (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled 1 in the Contribution (§ 1032(a)).

(4) The basis of each asset received by Controlled 1 in the Contribution will be equal to the basis of that asset in the hands of Distributing 1 immediately prior to its transfer (§ 362(b)).

(5) Controlled 1's holding period in each asset received in the Contribution will include the period during which Distributing 1 held the asset (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing 1 in the Internal Spin-Off (§ 361(c)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Distributing 2 upon its receipt of Controlled 1 stock in the Internal Spin-Off (§ 355(a)).

(8) The Cash Distribution will be treated as a distribution to Distributing 2 to which § 301 applies by reason of § 356(b).

(9) Distributing 2 must adjust its basis in its Distributing 1 stock due to the Cash Distribution (see §§ 1.1502-32(b)(2) and 1.1502-32(b)(3)(v)).

(10) The aggregate basis of the Distributing 1 and Controlled 1 stock in the hands of Distributing 2 will equal the aggregate basis of the stock of Distributing 1 (after the adjustment required by ruling (9) above) held by Distributing 2 immediately before the Internal Spin-Off, allocated between the Distributing 1 stock and the Controlled 1 stock in proportion to the fair market value of each under § 1.358-2(a)(2) (§ 358(a)(1) and (b)).

(11) The holding period of the Controlled 1 stock received by Distributing 2 will include the holding period of the Distributing 1 stock with respect to which the Internal Spin-Off is made, provided that such Distributing 1 stock is held as a capital asset on the date of the Internal Spin-Off (§ 1223(1)).

(12) Earnings and profits (if any) will be allocated between Distributing 1 and Controlled 1 in accordance with § 312(h) and §§ 1.312-10(a) and 1.1502-33(e).

Based solely on the information and representations submitted, we rule as follows regarding the External Spin-Off:

(13) No gain or loss will be recognized by Distributing 2 in the External Spin-Off (§ 355(c)).

(14) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the holders of Distributing 2 Common Stock upon their receipt of Distributing 1 stock in the External Spin-Off (§ 355(a)(1)).

(15) Each Distributing 2 shareholder's basis in a share of Distributing 2 Common Stock (as adjusted under § 1.358-1) shall be allocated between the share of Distributing 2 Common Stock with respect to which the External Spin-Off is made and the share of Distributing 1 stock (or allocable portions thereof) received with respect to the share of Distributing 2 Common Stock in proportion to their fair market values. If a Distributing 2 shareholder that purchased or acquired shares of Distributing 2 Common Stock on different dates or at different prices is not able to identify which particular share of

Distributing 1 stock (or portion thereof) is received with respect to a particular share of Distributing 2 Common Stock, the shareholder may designate which particular share of Distributing 1 stock (or portion thereof) is received with respect to a particular share of Distributing 2 Common Stock, provided the designation is consistent with the terms of the External Spin-Off.

(16) Each Distributing 2 shareholder's holding period in the Distributing 1 stock received (including any fractional share interest to which the shareholder may be entitled) will include the holding period of the Distributing 2 Common Stock with respect to which the External Spin-Off is made, provided that the Distributing 2 Common Stock is held as a capital asset on the date of the External Spin-Off (§ 1223(1)).

(17) Earnings and profits (if any) will be allocated between Distributing 2 and Distributing 1 in accordance with § 312(h) and §§ 1.312-10(b) and 1.1502-33(e).

Caveats

We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations or 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. In particular, we express no opinion regarding:

- (i) Whether the Internal Spin-Off and the External Spin-Off satisfy the business purpose requirement of § 1.355-2(b);
- (ii) Whether the Internal Spin-Off and the External Spin-Off are being used principally as a device for the distribution of the earnings and profits of Distributing 2, Distributing 1, or Controlled 1 (see § 355(a)(1)(B) and § 1.355-2(d));
- (iii) Whether the Internal Spin-Off and the External Spin-Off 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 Distributing 2, Distributing 1, or Controlled 1 (see § 355(e) and § 1.355-7); and
- (iv) The federal income tax treatment of the transactions described in steps (i), (ii), and (iii) above.

Procedural Statements

This letter ruling is directed only to the taxpayers who requested 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 federal 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 this letter.

Under a power of attorney on file in this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel (Corporate)