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Internal Revenue Service

Department of the Treasury

Significant Index Number: 402.07-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:

OP:E:EP:T:3

Date:

MAY 14 1999

Re: Private letter ruling request submitted on behalf of .

LEGEND:

Company A:

Company B:

Company C:

Company D:

Plan X:

Plan Y: employee stock ownership plan to be established by Company A

Dear

This is in response to a request for a private letter ruling, dated April 9, 1999, which was submitted on your behalf by your authorized representative concerning certain proposed transactions. Your authorized representative submitted the following facts and representations in support of the ruling request.

Prior to its reorganization as described below, Company A owned all of Companies B and D and % of Company C. Company A also maintained Plan X for the benefit of its employees and the employees of its controlled group members. Plan X is a stock bonus plan qualified under section 401(a) of the Internal Revenue Code and an employee stock ownership plan ("ESOP") which meets the requirements of Code section 4975(e)(7).

Company A conducted two principal lines of business through Company C and Company D, respectively. Company A completed a reorganization on , pursuant to which Company A and Company B ceased to be in the same controlled group within the meaning of Code sections 414(b), (c), (m), or (o), or 409(l). The reorganization involved the transfer by

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Code sections 414(b), (c), (m), or (o), or 409(l). The reorganization involved the transfer by Company A of its assets and liabilities relating to the line of business conducted by Company D to Companies B and D in exchange for their stock, followed by a pro rata distribution by Company A to its shareholders (including Plan X) of Company B stock ("spinoff"). Pursuant to the spinoff, Company A shareholders received one share of Company B stock for each share of Company A stock. Thus, Plan X now holds both Company A stock and Company B stock. The next step in the reorganization was the merger of Company C with and into Company A. Company A changed its name to the name of Company C, and Company B changed its name to the name of Company A. Plan X was transferred to and is now maintained by Company B. Company B has assumed all liability related to Plan X.

The Company A stock held in Plan X by participants to be employed by Company B is expected to be exchanged to the extent possible for Company B stock held in the Plan X accounts of participants to be employed by Company A within 90 days of the spinoff. Company B will then transfer Plan X assets equal to the account balances of Company C employees to Plan Y, after which any remaining Company B stock held by Plan Y will be exchanged for Company A stock held by Plan X, leaving Plan Y invested solely in Company A stock. After this exchange, Plan X will still hold approximately _____ shares of Company A stock, which will be sold in a secondary public offering to be held in _____. Sale proceeds will be approximately \$ _____. Plan X will use these proceeds to purchase shares of Company B stock.

According to a report prepared by Company A's investment banker ("Investment Banker"), participation in the secondary offering is the most effective means for selling the Company A stock held by Plan X because it will mitigate the negative impact on the market value that would result from the sale of approximately _____ shares of Company A stock in open-market sales. These shares represent approximately _____ % of the outstanding stock of Company A following the spinoff and merger. The secondary offering allows the identification of existing and new investors with a long-term investment objective and the arrangement of a coordinated sale to such investors in a single transaction, thus avoiding the timing and price uncertainties associated with open-market sales. The Investment Banker has concluded that selling the Company A stock in a single transaction as part of the secondary offering is in the best interest of Plan X because it represents the best opportunity to access maximum market liquidity with minimum market impact upon the sale of Company A shares.

For all of these reasons as set forth in the Investment Banker's report, Plan X intends to sell its Company A stock in the secondary offering. The Investment Banker has estimated that proceeds from this sale will be approximately \$ _____, which will be used to purchase approximately _____ shares of Company B stock. Such shares are approximately _____ % of the total outstanding shares of Company B.

The Investment Banker analyzed various factors to determine the number of trading days over which the purchase could be accomplished without significantly affecting the market price of Company B stock. The Investment Banker estimated a low, median and high average daily

trading volume based on the average daily trading volume during the last six months of companies in similar businesses and with a similar market capitalization to Company B. The Investment Banker recommends using a purchase rate not in excess of % of the average daily trading volume. Using these factors, the Investment Banker determined a low, median and high number of trading days for the purchase of Company B stock. The Investment Banker then considered certain circumstances which may additionally complicate the purchase. For example, Plan X will drain liquidity from the market because of the relative size of the purchases. As a result, public ownership of Company B will be reduced by approximately , which in turn is likely to result in a similar decrease in daily trading volume. The Investment Banker has concluded that it is in the best interest of Plan X to purchase Company B stock over a time period of 360 calendar days, which falls between the median and low (which is actually the largest) number of trading days.

Based on the above facts and representations, your authorized representative has requested the following rulings on your behalf:

1. The Company A stock retained by Plan X following the spinoff and merger will be treated as "securities of the employer corporation" for purposes of excluding net unrealized appreciation from income under section 402(e)(4) of the Internal Revenue Code on lump sum distributions from Plan X.
2. The 90-day reinvestment period under Code section 402(j)(2)(B) is extended for an additional 270 days, for a total of 360 days, so that determination of net unrealized appreciation shall be made without regard to the transactions in which the Plan X trustee disposed of Company A stock and used the proceeds to acquire Company B stock.
3. Since Company A shares are "securities of the employer corporation", with respect to Plan X for purposes of section 402(e)(4)(A), the 90-day period under section 402(j)(2)(B), or the extended period approved by the Service pursuant to ruling request number 2, above, will commence upon the actual sale of such Company A shares and not upon the date of the spinoff.

With respect to the first ruling request, Code section 402(e)(4)(A) generally provides that, in the case of a distribution other than a lump sum distribution, the amount actually distributed to any distributee from a qualified plan shall not include any net unrealized appreciation in securities of the employer corporation attributable to nondeductible employee contributions.

Code section 402(e)(4)(B) provides that, in the case of a lump sum distribution which includes securities of the employer corporation, unless a taxpayer elects otherwise, there shall not be included in gross income the net unrealized appreciation attributable to that part of the distribution which consists of securities of the employer corporation.

Section 1.402(a)-1(b)(2)(i) of the Income Tax Regulations provides that the amount of net unrealized appreciation in securities of the employer corporation which are distributed by the trust is the excess of the market value of such securities at the time of distribution over the cost

or other basis of such securities to the trust. Section 1.402(a)-1(b)(2)(ii) of the regulations sets forth the manner in which the cost or other basis to the trust of a distributed security of the employer corporation is calculated for purposes of determining the net unrealized appreciation on such security.

Code section 402(e)(4)(E) generally provides that the term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in subsections (e) and (f) of section 424) of the employer corporation.

In Revenue Ruling 73-29, 1973-1 C.B. 198, securities of an employer corporation held by its qualified trust were transferred to the qualified trust of an unrelated corporation when the first employer sold part of its business and transferred some of its employees to the unrelated corporation. It was held that shares of stock of the seller corporation distributed from the buyer's qualified trust to employees of the buyer corporation who were former employees of the seller corporation were securities of the employer corporation and will retain their character of employer securities even after those shares and the employees on whose account they were held were transferred to the unrelated corporation.

Prior to the spinoff, Company A was the employer corporation which maintained Plan X. Thus, prior to the spinoff, Company A stock constituted "securities of the employer corporation" within the meaning of Code section 402(e)(4)(E). After the spinoff, Plan X was transferred to Company B, which was no longer related to Company A pursuant to the spinoff. In accordance with Revenue Ruling 73-29, the shares of Company A stock held by Plan X retain their character as employer securities for purposes of Code section 402(e).

Accordingly, with respect to the first requested ruling, we conclude that the Company A stock retained by Plan X following the spinoff and merger will be treated as "securities of the employer corporation" for purposes of excluding net unrealized appreciation from income under Code section 402(e)(4) on lump sum distributions from Plan X.

With respect to the second requested ruling, Code section 402(j) provides in pertinent part that the determination of net unrealized appreciation shall be made without regard to a transaction in which the plan trustee disposes of securities of the employer corporation and uses the proceeds of such disposition to acquire securities of the employer corporation within 90 days (or such longer period as the Secretary may prescribe), except that this subparagraph shall not apply with respect to any employee with respect to whom a distribution of money was made during the period after such disposition and before such acquisition.

In the present case, the Investment Banker has concluded, based upon the factors presented above, that selling the Company A stock in a single transaction as part of the secondary offering is in the best interest of Plan X because it represents the best opportunity to access maximum market liquidity with minimum market impact upon the sale of Company A shares. Failure to participate in the secondary offer could lessen the sale proceeds received by Plan X. Based on its analysis of the projected Company B trading volume, which included a comparison with

comparable companies and considered the effect of the size of the acquisitions and the reduced public ownership, the Investment Banker further concluded that it is in the best interest of Plan X for the purchases of Company B stock to occur over a period of 360 calendar days from the date of the sale of Company A stock.

Accordingly, we conclude with respect to the second requested ruling that the 90-day reinvestment period under Code section 402(j)(2)(B) is extended for an additional 270 days, for a total of 360 calendar days, so that determination of net unrealized appreciation shall be made without regard to the transactions in which the Plan X trustee disposed of Company A stock and used the proceeds to acquire Company B stock.

With respect to the third requested ruling, we concluded in the first ruling that shares of Company A stock retained by Plan X after the spinoff and merger will be treated as "securities of the employer corporation". Thus, the sale by Plan X of its Company A stock is a disposition of "securities of the employer corporation", and the date of such disposition begins the 90-day period described in Code section 402(j)(2)(B).

Accordingly, we conclude with respect to the third requested ruling that, since Company A shares are "securities of the employer corporation", with respect to Plan X for purposes of section 402(e)(4)(A), the 90-day period under section 402(j)(2)(B), as extended to 360 calendar days pursuant to the second ruling, will commence upon the actual sale of such Company A shares and not upon the date of the spinoff.

This ruling letter assumes that Plan X and Plan Y are qualified under Code section 401(a), and their related trusts exempt from tax under section 501(a), at all times relevant thereto. It also assumes that Plan X and Plan Y meet the requirements of Code section 4975(e)(7).

Pursuant to a power of attorney on file in this office, the original of this letter is being sent to your authorized representative.

Sincerely yours,



Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures
Notice 437
Deleted copy of ruling letter