

Internal Revenue Service

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Person to Contact:

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LEGEND

Distributing =

Controlled =

Subsidiary 1 =

Investment Bank =

Business A =

Business B =

Agreement A =

Type A =

Type B =

Event X =

State X =

\$A =

\$B =

Year A =

Year B =
Year C =
Date A =
Date B =
Date C =
Date D =
Date E =
A% =
B% =
C% =
D% =
#A =
#B =
#C =
#D =
#E =
#F =
#G =
#H =
#J =
#K =

Dear

This letter responds to your July 13, 2001 request for rulings on certain federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated October 30, 2001, November 13, 2001, December 3, 2001, January 10, 2002, January 17, 2002, January 18, 2002 and February 6, 2002. The information submitted for consideration is summarized below.

Facts

Distributing is a publicly traded State X corporation and common parent of an affiliated group filing a consolidated return. Distributing was incorporated in State X in Year A and is engaged in Business A. Distributing owns the stock of several subsidiaries, including Controlled and Subsidiary 1. Subsidiary 1 was formed in State X in Year B and is engaged in Business B. Controlled is a holding company that was incorporated in State X in Year C.

The authorized stock of Distributing consists of Distributing Class B Common Stock, Series A Preferred Stock and Series B Preferred Stock. None of the Series A Preferred Stock is issued and outstanding. The Series B Preferred stock is nonvoting and is owned by #A shareholders. There are over #B shareholders of the Distributing Class B Common Stock. Several of the over #B shareholders own 5% or greater of the Distributing Class B Common Stock. On Date A, Distributing completed a stock offering of #C shares of its Class B Common Stock. After the Date A stock offering, Distributing had approximately #D shares of Class B Common Stock outstanding. On Date B, Distributing issued \$A of #E year convertible notes to the public. The notes carry a A% coupon rate and are convertible into #F shares of Distributing Class B Common Stock. Distributing completed both the Date A stock offering and the Date B issuance of convertible notes in response to the effects of Event X.

Since its formation, Controlled had #G shares of common stock authorized, issued and outstanding, all of which had been held by Distributing.

Proposed Transaction

To effect the separation of Business B, Distributing proposes the following series of steps (some of which already have been consummated) (collectively, the "Proposed Transaction"):

- I. On Date C, Distributing contributed all of the stock of Subsidiary 1 to Controlled. No additional shares of Controlled were issue.
- II Subsequently, on Date D, after determining the appropriate number of shares of Controlled Class A and Class B Common Stock necessary to effectuate the Proposed Transaction, Controlled recapitalized its outstanding shares of common stock owned by Distributing into #H shares of Class A Common Stock (hereinafter referred to as "Class A Stock") (possessing #A votes per shares) and #J shares of Class B Common Stock (hereinafter referred to as "Class B Stock") (possessing #K votes per share). Each share of Class B Stock is convertible, at the option of Distributing or its affiliates prior to the distribution, into #A shares of Class A Stock.

- III. In connection with the Proposed Transaction, Investment Bank will acquire approximately \$B of outstanding Distributing indebtedness from the debt holders. Such acquisitions will occur at fair market value.
- IV. Controlled will complete an initial public offering ("IPO") of its Class A Stock (the "Controlled IPO"). Controlled will loan the proceeds received in the Controlled IPO to Subsidiary 1 in exchange for a debt obligation that, as represented, will constitute a security. Subsidiary 1 will utilize the proceeds to repay a portion of its note payable to Distributing.
- V. Distributing will transfer a portion of the Class A Stock having a value of approximately \$B to Investment Bank in satisfaction of the \$B of its debt held by Investment Bank.
- VI. Investment Bank will sell its Class A Stock in connection with the Controlled IPO (the "Secondary Offering").
- VII. Shortly following the Controlled IPO, Distributing will distribute its remaining shares of Class A and Class B Stock to Distributing's shareholders pro rata (the "Distribution"). Cash will be issued in lieu of fractional shares. Upon receipt of the Class B Stock by the Distributing shareholders, the conversion feature associated with such shares will be eliminated. Accordingly, the Class B Stock will no longer be convertible into Class A Stock.

Representations

The following representations are made with respect to the Proposed Transaction:

- (a) The Distributing shareholders will receive solely shares of Controlled stock (Class A Stock and Class B Stock) in the Distribution.
- (b) Neither Distributing nor Controlled will have been a United States real property holding corporation (as defined in § 897(c)(2)) at any time during the five-year period ending on the date of Distribution. Neither Distributing nor Controlled will be a United States real property holding corporation immediately after the Distribution.
- (c) The indebtedness owed by Controlled to Distributing, if any, after the Distribution of the Controlled stock will not constitute stock or securities. The indebtedness owed by Subsidiary 1 to Distributing after the Distribution of Controlled's stock will not constitute stock or securities.
- (d) 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.

- (e) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) The 5 years of financial information submitted on behalf of Controlled is representative of its current operations, with the exception that as effective Date E, Distributing and Controlled converted from a Type A arrangement to a Type B arrangement. The conversion to a Type B arrangement affected only the method of allocating revenues and expenses between Distributing and Controlled associated with the ongoing active conduct of those corporations' trades or businesses and did not constitute a change in the operation of the active trades or businesses. There have been no substantial operational changes since the date of the last financial statement provided.
- (g) Immediately after 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 Subsidiary 1, which is engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (h) The gross assets of the trades or businesses relied on to satisfy the active business requirement of § 355(b) will have a fair market value that is 5 percent or more of the total fair market value of the gross assets of the corporation directly conducting the trades or businesses.
- (i) Following the transaction, Distributing, directly, and Controlled, indirectly through Subsidiary 1, will each continue the active conduct of its trade or business, independently and with its own separate employees except that certain transitional services will be provided by Distributing to Controlled after the Distribution, pursuant to the terms of Agreement A.
- (j) The Distribution of the stock of Controlled is carried out for the business purpose of enhancing the effectiveness of a stock offering by Controlled.
- (k) 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 its best knowledge, is not aware of any plan or intention on the part of any other 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 transaction, except sales of fractional shares of Controlled stock distributed in the Distribution. The foregoing shall not be construed to prevent any 5-percent shareholder from disposing of such stock on behalf of its clients in the normal course of its business based upon decisions as to existing market conditions.

- (l) 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.
- (m) 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 transaction, except in the ordinary course of business.
- (n) No liabilities will be assumed by Controlled in connection with the Proposed Transaction.
- (o) 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, 1995-32 I.R.B. 6, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, Controlled's excess loss account, if any, with respect to the Subsidiary 1 stock, and any other excess loss accounts appropriately triggered by the Distribution (after taking into account appropriate investment adjustments resulting from the trigger of Controlled's excess loss account in the stock of Subsidiary 1 under § 1.1502-32), will be included in income immediately before the Distribution (See § 1.1502-19).
- (p) 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.
- (q) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (r) Distributing and Controlled and their respective shareholders will each pay their own expenses, if any, incurred in connection with the Distribution.
- (s) Immediately after the Distribution, no person will hold, directly or indirectly, disqualified stock (within the meaning of § 1.355-6(b)(2)) in Distributing or Controlled that constitutes a 50 percent or greater interest in Distributing or Controlled.
- (t) The Distribution is not part of a plan or series of related transactions (within the meaning of section 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.

- (u) There is no plan or intention by any shareholder who owns 5 percent or more of the stock of Distributing, and the managements of Distributing and Controlled, to their best knowledge, are not aware of any plan or intention on the part of any particular remaining shareholder or security holder of Distributing to purchase additional shares of Controlled stock following the Distribution which would cause the shareholder to own, in the aggregate, more than B% of the total voting power of the outstanding shares of Controlled stock.
- (v) There is no plan or intention by the managements of Distributing or Controlled to exchange, redeem, recapitalize, repurchase, or in any other way convert the shares of Controlled's Class B Stock outstanding after the Distribution.
- (w) Immediately prior to the Distribution, the only outstanding stock in Controlled not held by Distributing will be shares of voting Class A Stock held by the public and/or Investment Bank. These shares of Class A Stock that Distributing does not own will hold less than C% of the then outstanding vote in Controlled and will constitute less than D% of the value of all the outstanding Controlled stock.
- (x) Each share of Class B Stock will be convertible, while held by Distributing or its affiliates before the Distribution, into #A shares of Class A Stock. After the Distribution, the Class B Stock will not be convertible into any other class of Controlled stock. The Class A Stock will not be convertible at any time into any other class of Controlled stock. Controlled will not have any class of stock outstanding except its Class A Stock and Class B Stock.
- (y) The payment of cash in lieu of fractional shares of Controlled stock is solely for the purpose of avoiding the expense and inconvenience to Controlled of issuing fractional shares and does not represent separately bargained-for consideration. The total cash consideration that will be paid in the Distribution to the Distributing shareholders instead of issuing fractional shares will be de minimis. The fractional share interests of each Distributing shareholder will be aggregated, and no Distributing shareholder will receive cash in an amount equal to or greater than the value of one full share of Controlled stock.
- (z) All of the steps of the Proposed Transaction are part of a single overall plan.
- (aa) The debt obligation created by Controlled's loan to Subsidiary 1 of the proceeds of the Controlled IPO will constitute a security.

- (bb) Investment Bank will be acting for its own account in acquiring Distributing obligations and exchanging those Distributing obligations for shares of Class A Stock, and attempting to sell such Class A Stock to the public in the Secondary Offering.
- (cc) At the time of the Distribution, no shareholder of Distributing that is not exempt from the B% voting cap limitation will receive B% of the voting power of Controlled stock in the Distribution.
- (dd) The proposed pro rata Distribution by Distributing of the stock of Controlled to Distributing's shareholders (as described in Step VII of the Proposed Transaction) will occur on or before the earlier of: (i) the date that is twelve months after the date of consummation of the Controlled IPO (described in Step IV of the Proposed Transaction), or (ii) the date that is twelve months after the date of the receipt of a favorable private letter ruling from the Internal Revenue Service.

Rulings

Based on the information submitted and the representations made, it is held as follows:

- (1) The Class A Stock and the Class B Stock held by Distributing at the end of Step II will be considered as having been received by Distributing in exchange for the stock of Subsidiary 1 on Date C.
- (2) The transfer by Distributing of Subsidiary 1 stock to Controlled solely in exchange for Controlled stock followed by the Distribution will qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be a "party to a reorganization" within the meaning of § 368(b).
- (3) Distributing will recognize no gain or loss upon the transfer of the Subsidiary 1 stock to Controlled in exchange for Controlled stock (Section 361(a)).
- (4) Controlled will recognize no gain or loss upon the receipt of Subsidiary 1 stock in exchange for Controlled stock (Section 1032(a)).
- (5) The basis of the Subsidiary 1 stock in the hands of Controlled will be the same as the basis of such stock in the hands of Distributing immediately prior to the transfer (Section 362(b)).
- (6) The holding period of the Subsidiary 1 stock in the hands of Controlled will include the period during which such stock was held by Distributing (Section 1223(2)).

- (7) The Class A Stock transferred by Distributing to Investment Bank in Step V will constitute "qualified property" within the meaning of § 361(c)(2)(B). The transfer by Distributing to its creditor, Investment Bank, of this Class A Stock constituting qualified property will not result in the recognition of gain or loss to Distributing. (Sections 361(c)(1) and (3)).
- (8) Distributing will recognize no gain or loss upon the Distribution to its shareholders of the Class A and Class B Stock in the Distribution (Section 361(c)(1)).
- (9) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders upon the receipt of the Controlled stock in the Distribution (Section 355(a)(1)).
- (10) Any Distributing shareholder receiving cash in lieu of a fractional share of Controlled stock will be viewed as if he, she, or it had received the fractional share interest and then had immediately transferred the interest to Controlled for redemption. The cash payment will be treated as having been received as a distribution in full payment in exchange for the stock redeemed (section 302(a)). Provided the fractional share interest is a capital asset in the hands of the exchanging shareholder, the gain or loss will be capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code (sections 1221 and 1222).
- (11) The aggregate basis of the Distributing stock and the Controlled stock held by each shareholder of Distributing immediately after the Distribution will be same as the basis of the Distributing stock held by such shareholder immediately before the Distribution. The total basis will be allocated between the shares of Distributing stock and Controlled stock in proportion to the relative fair market values of each in accordance with § 1.358-2(a) (Section 358(b)(2)).
- (12) The holding period of the Controlled stock received in the Distribution by the shareholders of Distributing will include the holding period of the Distributing stock with respect to which the Distribution will be made, provided that such Distributing stock is held as a capital asset on the date of the Distribution (Section 1223(1)).
- (13) As provided in Section 312(h), proper allocation and adjustment of earnings and profits between Distributing and Controlled will be made in accordance with § 1.312-10(a).

Caveats and Procedural Statements

- (1) The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.
- (2) Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.
- (3) 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.
- (4) A copy of this letter must be attached to any income tax return to which it is relevant.

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

Sincerely yours,
Alfred C. Bishop, Jr.
Branch Chief, Branch 6
Office of Associate Chief Counsel (Corporate)

cc: