

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:B05 PLR-111227-00
Date:
August 1, 2000

In re:

Distributing =

Controlled =

Business A =

Business B =

Business C =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

Sub 7 =

Sub 8 =

Sub 9 =

Sub 10 =

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- Sub 11 =
- Sub 12 =
- Sub 13 =
- Sub 14 =
- Sub 15 =

- Sub 16 =
- Sub 17 =
- a =
- b =
- m =
- n =
- x =
- y =
- z =
- Facility =
- Financial Advisors =

Dear

This letter responds to your June 2, 2000 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in this request and in subsequent correspondence is summarized below.

Publicly traded Distributing is the common parent of a consolidated group that conducts Business A and Business B through its subsidiaries. Distributing owns all of the stock of Sub 1, Sub 2, Sub 3, Sub 4, Sub 5 and Controlled. Distributing owns all of

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the common stock of Sub 6, Sub 7, Sub 8, and Sub 9. Sub 6, Sub 7, Sub 8, and Sub 9 each have outstanding nonvoting, nonparticipating preferred stock that is publicly traded (collectively, the "Subsidiary Preferred Stock"). Controlled owns all of the stock of Sub 10, Sub 11, and Sub 12. Sub 11 owns all of the stock of Sub 15. Sub 15 owns all of the stock of Sub 16 and Sub 17.

We have received financial information indicating that Business A, which will be conducted by Distributing through its subsidiaries, and Business B, which will be conducted by Controlled, each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past 5 years. Controlled may acquire additional Business B assets for cash through one or more single member limited liability companies ("LLCs") owned by Controlled.

To further certain business goals, Distributing and Controlled wish to raise additional capital through an initial public offering of up to 20 percent of the stock of Controlled (the "Offering"). As part of the same plan and after the Offering, Distributing proposes to distribute the stock of Controlled pro rata to its shareholders (the "Controlled Distribution").

The Financial Advisers have concluded that the required additional capital should be raised in the equity market in the Offering in connection with the Controlled Distribution. In particular, the Financial Advisers have advised Distributing that the Offering in connection with the Controlled Distribution will permit Distributing and Controlled to raise significantly more funds per share (net of transaction costs) than an additional offering of Distributing common stock or an offering of Controlled common stock without the Controlled Distribution. Although Controlled may issue debt at the same time, the Financial Advisers have advised that incurring more debt than is currently planned is inadvisable because it would adversely affect Distributing's and/or Controlled's credit profile and their financial flexibility.

The Financial Advisers have also advised Distributing's management that Sub 13 and Sub 14 are not an integral part of Controlled's high growth strategy, and that the separation of Sub 13 and Sub 14 from Controlled is necessary because the public will not properly value Sub 13 and Sub 14 in the Offering.

Furthermore, as described below, Business B is subject to extensive regulation as a result of its affiliation with Distributing and Business A. This regulation affects Business B's organization, operation, and ability to raise capital and expand its businesses. Certain competitors of Controlled are not subject to the same restrictions. The Controlled Distribution will permit Business B to operate without such regulation.

Distributing and/or Controlled have issued, and expect to continue issuing, stock options as compensation to officers, employees, and directors (hereinafter referred to as the "Compensatory Options"). Currently, Distributing has certain options

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outstanding. At the time of the Offering, Controlled's employees will exchange their options in Distributing for options in Controlled.

The Proposed Transaction

To accomplish this separation, Distributing has proposed the following transaction:

(i) Controlled has arranged for an additional credit facility for up to \$a from a third-party lender (the "Borrowing").

(ii) Controlled will distribute approximately \$b of the proceeds of the credit facility to Distributing.

(iii) Controlled will amend its charter and increase its authorized shares from x shares of common stock, par value \$m, and no shares of preferred stock, to approximately y shares of common stock, par value \$n, and a number of shares of preferred stock (yet to be determined). Distributing's x shares of Controlled common stock will be converted into approximately z shares of Controlled common stock.

(iv) Distributing and Controlled must have regulatory approval in order for Controlled to distribute Sub 13 and Sub 14 to Distributing, and such approval may not be obtained before the Offering. In order to facilitate Controlled's transfer of these corporations to Distributing, Controlled will distribute a special class of preferred stock to Distributing (the "Controlled Preferred Stock"). The Controlled Preferred Stock will have only the right to be redeemed for the stock of Newco (described below and formed to facilitate the Offering through the distribution of Sub 13 and Sub 14) once regulatory approval is obtained.

(v) Controlled will make the Offering.

(vi) Controlled will form a new corporation ("Newco"). Controlled will contribute Sub 13 and Sub 14 to Newco in return for stock of Newco.

(vii) Newco will form a single member LLC ("Newco LLC") whose owner for U.S. tax purposes will be Newco. Sub 1 will contribute Business C to Newco LLC in exchange for more than 5 percent but less than 20 percent of Newco's stock (the "Sub 1 Contribution").

(viii) Sub 10 will be converted into a single member LLC, whose owner for U.S. tax purposes will be Controlled.

(ix) If the acquisition of certain additional Business B assets does not occur prior to the time of the Controlled Distribution, Sub 11, Sub 15, Sub 16, and Sub 17 will each be converted into a single member LLC, whose owner for U.S. tax purposes will be

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Controlled.

(x) Controlled will distribute all of its stock in Newco to Distributing in redemption of the Controlled Preferred Stock issued in step (iv) above (the "Newco Distribution").

(xi) Controlled may purchase certain Business B assets under construction (the "Facility") from Sub 7 and will place the Facility in a single member LLC owned by Controlled. If so, Controlled will also enter into various continuing agreements with respect to the ongoing construction and future operation of the Facility.

(xii) Distributing will cause Sub 6, Sub 7, Sub 8, and Sub 9 to permanently recapitalize the Subsidiary Preferred Stock into voting preferred stock (the "Recapitalization"). The Recapitalization will result in a permanent realignment of the capital structure of these companies. Based on the advice of its financial advisers, Sub 6, Sub 8, and Sub 9 may make a cash payment to the shareholders of the Subsidiary Preferred Stock that vote in favor of the Recapitalization (the "Consent Payment").

(xiii) Distributing will distribute all of its Controlled stock to the shareholders of Distributing in the Controlled Distribution.

The Representations

In connection with these transactions, the following representations are made:

The Recapitalization

The Recapitalization will qualify as a reorganization under § 368(a)(1)(E).

The Sub 1 Contribution

The Sub 1 Contribution will qualify as a tax free exchange under § 351(a).

The Newco Distribution

- (a) Controlled, Newco, and their respective shareholders will each pay their own expenses, if any, incurred in connection with the Newco Distribution.
- (b) No part of the consideration distributed by Controlled will be received by Distributing as a creditor, employee, or in any capacity other than as a shareholder of Controlled.
- (c) Following the Newco Distribution, Newco and Controlled will each continue the active conduct of their respective businesses, independently and with their separate employees.

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- (d) Newco will not assume any liabilities in the contribution of Sub 13 and Sub 14 by Controlled, and the assets transferred by Controlled to Newco will not be subject to any liabilities.
- (e) No intercompany debt will exist between Controlled and Newco at the time of, or subsequent to, the Newco Distribution.
- (f) Controlled and Newco are not investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (g) The 5 years of financial information submitted on behalf of Controlled and Newco is representative of each corporation's present operations, and with regard to each corporation, there have been no substantial operational changes since the date of the last financial statement submitted.
- (h) There is no plan or intention to liquidate either Controlled or Newco, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation subsequent to the Newco Distribution, except in the ordinary course of business.
- (i) Except for the Offering and the Controlled Distribution, there is no plan or intention on the part of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of the stock in, or securities of, either Controlled or Newco after the Newco Distribution.
- (j) Payments made in connection with all continuing transactions, if any, between Controlled and Newco, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (k) The gross assets of the trade or business conducted by Controlled that will be relied upon to satisfy the active trade or business requirement of § 355(b) will, in the aggregate, have a fair market value that is not less than 5 percent of the total fair market value of the gross assets of Controlled.
- (l) The gross assets of the trade or business conducted by Newco that will be relied upon by Newco to satisfy the active trade or business requirement of § 355(b) will, in the aggregate, have a fair market value that is not less than 5 percent of the total fair market value of the gross assets of Newco.
- (m) The Newco Distribution will be carried out for the following corporate business purpose: to facilitate the Offering. The Newco Distribution is

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motivated, in whole or substantial part, by this corporate business purpose.

- (n) There is no plan or intention by either Controlled or Newco, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Newco Distribution, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.
- (o) Items of income, gain, loss, deduction, and credit, if any, will be taken into account as required by the applicable intercompany transaction regulations (See § 1.1502-13 and § 1.1502-14 of the Income Tax Regulations as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; and § 1.1502-13 as published by T.D. 8597). Further, the excess loss account, if any, with respect to the Newco common stock will be included in income at the appropriate time (See § 1.1502-19).
- (p) The Newco 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 Controlled or Newco or stock possessing 50 percent or more of the total value of all classes of stock of Controlled or Newco.
- (q) It is anticipated that at the time of the Controlled Distribution, Controlled will be a publicly traded corporation, the stock of which will be regularly traded on an established securities market as defined in § 1.897-1(m)(1) and (3); Controlled does not know, and has no reason to know, of any foreign person who owns or will own 5 percent or more of Controlled stock either before or after the Newco Distribution. To the best of its knowledge and belief, neither Controlled nor Newco was a U.S. real property holding corporation (as defined in § 897(c)(2)) at any time during the 5-year period ending on the date of the Newco Distribution, and neither Controlled nor Newco will be a United States real property holding corporation immediately after the Newco Distribution.
- (r) The 5 years of financial information submitted by Sub 1 concerning business C is representative of the corporation's present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (s) The Newco Distribution will occur within the later of 3 months after the receipt of a favorable ruling and 12 months after the Offering is completed.

The Controlled Distribution

- (a) Distributing is a publicly traded corporation, the stock of which is regularly traded on an established securities market as defined in § 1.897-1(m)(1) and (3); Distributing does not know, and has no reason to know, of any foreign person who owns or will own 5 percent or more of Distributing stock either before or after the Controlled Distribution. To the best of its knowledge and belief, neither Distributing nor Controlled was a U.S. real property holding corporation (as defined in § 897(c)(2)) at any time during the 5-year period ending on the date of the Controlled Distribution, and neither Distributing nor Controlled will be a U.S. real property holding corporation immediately after the Controlled Distribution.
- (b) 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.
- (c) Immediately after the Controlled Distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (d) The 5 years of financial information submitted on behalf of Controlled 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.
- (e) The 5 years of financial information submitted on behalf of Sub 1, Sub 2, Sub 3, Sub 4, Sub 6, Sub 7, Sub 8, and Sub 9 is representative of each 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 Controlled Distribution will be carried out for the following corporate business purpose: to raise additional capital in the Offering. The Controlled Distribution is not motivated in whole or substantial part by any non-corporate business purpose.
- (g) The management of Distributing, to its best knowledge, is not aware of any plan or intention on the part of any particular 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.

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- (h) 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 section 4.05(1)(b) of Rev. Proc. 96-30.
- (i) 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.
- (j) The Compensatory Options will contain customary terms and conditions, will be granted in connection with the performance of services for Distributing or Controlled or a person related to the grantor under § 355(d)(7)(A), will not be excessive by reference to the services performed, and, immediately after the Controlled Distribution and within 6 months thereafter, (i) will be non-transferable within the meaning of § 1.83-3(d), and (ii) will not have a readily ascertainable fair market value as defined in § 1.83-7(b).
- (k) 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.
- (l) Other than the indebtedness related to the agreements to be entered into by Distributing and Controlled, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Controlled Distribution.
- (m) Immediately before the Controlled 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, 1995-2 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 stock will be included in income immediately before the Controlled Distribution (See § 1.1502-19).
- (n) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (o) The Controlled 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

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of Distributing or Controlled or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.

- (p) The Controlled Distribution will occur within the later of 3 months after the receipt of a favorable ruling and 12 months after the Offering is completed.

The Rulings

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

The Cash Distribution

1. The distribution by Controlled to Distributing of part of the proceeds of the Borrowing will constitute a distribution within the meaning of § 301.

The Newco Distribution

2. The contribution by Controlled to Newco of Sub 13 and Sub 14 in exchange for the stock of Newco, followed by Controlled's distribution of Newco stock to Distributing in redemption of all of the Controlled Preferred Stock will constitute a reorganization within the meaning of § 368(a)(1)(D). Controlled and Newco will each be a "party to a reorganization" within the meaning of § 368(b).
3. No gain or loss will be recognized by Controlled on its transfer of Sub 13 and Sub 14 to Newco in exchange for Newco stock (§ 361(a)).
4. No gain or loss will be recognized by Newco on its receipt of Sub 13 and Sub 14 from Controlled in exchange for Newco stock (§ 1032).
5. No gain or loss will be recognized by Controlled upon the distribution to Distributing of all of Controlled's Newco stock (§ 361(c)(1)).
6. No gain or loss will be recognized by Distributing upon its receipt of Controlled's Newco stock (§ 355(a)(1)).
7. The basis of Sub 13 and Sub 14 in the hands of Newco will be the same as the basis of Sub 13 and Sub 14 in Controlled's hands immediately before the Newco Distribution (§ 362(a)).
8. The aggregate basis of Distributing's Controlled and Newco stock after the Newco Distribution will be the same as Distributing's aggregate basis in Controlled immediately before the Newco Distribution, allocated in

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proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(b)(2)).

9. The holding period of the Sub 13 stock and the Sub 14 stock received by Newco in the contribution from Controlled will include the period during which Controlled held such assets (§ 1223(2)).
10. The holding period of Newco stock received by Distributing from Controlled will be the same as the holding period of the Controlled shares on which the distribution is made, provided that such Controlled shares are held as a capital asset on the date of the distribution (§ 1223(1)).
11. As provided in § 312(h), proper allocation of earnings and profits between Controlled and Newco will be made in accordance with § 1.312-10(a).

The Controlled Distribution

12. The payment of the Consent Payment will not cause the Recapitalization to be a transaction in which gain or loss is recognized in whole or in part within the meaning of § 355(b)(2)(D).
13. No gain or loss will be recognized by Distributing upon the distribution of the Controlled stock to Distributing's shareholders (§ 355(c)).
14. No gain or loss will be recognized by Distributing's shareholders upon their receipt of the Controlled stock (§ 355(a)(1)).
15. The aggregate basis of the Distributing shareholders' Controlled and Distributing stock after the Controlled Distribution will be the same as such shareholders' aggregate basis in Distributing immediately before the Controlled Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(b)(2)).
16. The holding period of the Controlled stock received by the Distributing shareholders will include each shareholder's holding period of the Distributing shares on which the distribution is made, provided that such Distributing stock is held as a capital asset on the date of the transaction (§ 1223(1)).
17. As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 1.312-10(b).

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18. If cash is received by a Distributing shareholder (as a result of a sale of a fractional share of Controlled stock by the distribution agent), the shareholder will have gain or loss measured by the difference between the basis of the fractional share, as determined in ruling 15 above, and the amount of cash received. If the Controlled stock qualifies as a capital asset in the hands of the shareholder, the gain or loss will be capital gain or loss subject to the provisions and limitations of §§ 1221 and 1222.
19. The issuance or exercise of a Compensatory Option will not be an acquisition of stock for purposes of § 355(e).

Caveats

We express no opinion about the tax treatment of 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 proposed transaction that are not specifically covered by the above rulings. In particular, we express no opinion about the tax treatment of the Recapitalization or the conversion of Sub 10, Sub 11, Sub 15, Sub 16, and Sub 17 into single member LLCs.

Procedural Matters

This 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.

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

Pursuant to the power of attorney on file in this office, copies of this letter have been sent to the taxpayer's authorized representatives.

Sincerely yours,
Associate Chief Counsel (Corporate)

By: Filiz A. Serbes

Assistant to the Chief, Branch 5