

**Internal Revenue Service**

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Distributing =

Controlled I =

Controlled II =

Controlled III =

State X =

State Y =

A =

business 1 =

business 2 =

business 3 =

business 4 =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

n =

o =

p =

Notes =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

This letter replies to a request for rulings dated April 6, 1999, on the federal income tax consequences of proposed transactions concerning § 355 of the Internal Revenue Code. We received additional information in letters dated June 2, June 24, July 12, July 16, July 21, July 27, August 16, September 8, September 22, September 24, September 29, and September 30, 1999. The information submitted for consideration is summarized below.

Distributing is a State X corporation with two classes of voting common stock outstanding. Class A and B are identical except that Class B has ten times the vote that Class A has. Only one shareholder has a beneficial ownership of more than 5 percent of Distributing stock. The shareholder, A, owns a percent of Distributing by value and b percent of Distributing's voting power. A is a founder of Distributing and has owned his shares for many years. The Distributing stock is publicly traded. Distributing owns all of the stock of Controlled I, a State Y corporation, and c% (an amount greater than 80%) of the stock of Controlled II, also a State Y corporation. Controlled I and Controlled II each have one class of common stock outstanding. Controlled I and Controlled II will be reincorporated in State X as part of the proposed transaction. Distributing operates businesses 1, 2, 3, and 4.

Since Date 1 Distributing has issued shares of its stock in several acquisitive transactions and private placement offerings. In these transactions and offerings the following amounts of Distributing Class A shares were issued: d shares on Date 2; e shares on Date 3; f shares on Date 4; g shares on Date 5; h shares on Date 6; i shares on Date 7; and j shares on Date 8. Since Date 1 Distributing has also issued k shares in other miscellaneous transactions. In total, l shares of Distributing, representing m% (which is between 20 and 25 percent) of the currently outstanding Distributing stock,

have been issued pursuant to the acquisitions, private placement offerings, and other transactions described above (which are hereinafter collectively referred to as the "Issuances"). In addition, Distributing has regularly issued shares of its stock before and since Date 1 upon the exercise of stock options issued as part of its employee compensation plan. Controlled II also has outstanding stock options issued as part of its employee compensation plan. Distributing, Controlled I, Controlled II, and Controlled III may issue stock options after the distributions to their respective employees.

We have received financial information indicating that Distributing's businesses 1, 2, 3, and 4 each had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Distributing intends to issue stock to the public to generate capital to be used for the development of all four businesses. Distributing has received letters from an investment banker advising Distributing that (1) the proceeds from stock offerings will be maximized if businesses 2, 3, and 4 are contributed to three controlled corporations and these controlled corporations are spun off prior to public offerings of their stock, and (2) public offerings of the stock of these controlled corporations will be a more effective way of raising capital for Distributing's businesses than alternative methods. Accordingly, Distributing has proposed the following transaction:

- (i) Distributing will reincorporate Controlled I and Controlled II in State X and organize Controlled III as a State X corporation with a single class of common stock outstanding. Distributing will transfer the assets of businesses 2, 3, and 4 to Controlled I, Controlled II, and Controlled III, respectively, in exchange for stock (actually or constructive issued, as the case may be), of the controlled corporations, the Notes (which are short term promissory notes stating a market rate of interest issued by Controlled II and III, respectively, in favor of Distributing), and the assumption by the controlled corporations of certain Distributing liabilities.
- (ii) Distributing will distribute to holders of its common stock all of its shares of Controlled I, II, and III stock on a pro rata basis.
- (iii) Controlled I, II, and III will issue approximately n, o, and p shares to the public, respectively, in initial public offerings ("the Offerings"). The Offerings will be consummated within one year from the date of this letter.

The taxpayer has made the following representations in connection with the proposed transaction.

- (a) 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 the corporation.

- (b) The five years of financial information submitted on behalf of Distributing are representative of the corporation's present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the transaction, Distributing and Controlled I, II, and III will each continue the active conduct of its respective business independently and with its own separate employees.
- (d) The distributions of stock of Controlled I, II, and III are being carried out for the following corporate business purpose: to maximize the value received upon a public offering of stock of each of Controlled I, II, and III in order to raise funds for use in each controlled business and in business 1 retained by Distributing. The distributions of the stock of Controlled I, II, and III are motivated in whole, or substantial part, by this corporate business purpose.
- (e) There is no plan or intention by the shareholder who owns 5 percent or more of the stock of Distributing, and the management of the Distributing corporation, to the best of its knowledge, is not aware of any plan or intention on the part of any 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 I, II, or III after the transaction.
- (f) There is no plan or intention by either Distributing or Controlled I, II, or III, 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.
- (g) There is no plan or intention to liquidate Distributing or Controlled I, II, or III, to merge any of these corporations with any other corporation, or to sell or otherwise dispose of the assets of any of these corporations subsequent to the transaction, except in the ordinary course of business.
- (h) The total adjusted bases and the fair market value of the assets transferred to Controlled I, II, or III by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled I, II, or III, respectively, plus any liabilities to which the assets transferred are subject. The liabilities to be assumed in the transaction 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.
- (i) Distributing neither accumulated its receivables nor made an extraordinary payment of its payables in anticipation of the transaction.

- (j) No intercorporate debt will exist between Distributing and Controlled I, II, or III at the time of, or subsequent to, the distributions of Controlled I, II, or III stock other than the Notes. The Notes will be payable in 16 quarterly payments of principal and interest. The Notes will not constitute stock or securities of Controlled II or III.
- (k) Immediately before the distributions, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Furthermore, Distributing's excess loss account, if any, with respect to the Controlled I, II, or III stock will be included in income immediately before the distributions.
- (l) Payments made in connection with all continuing transactions between Distributing and Controlled I, II, or III will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) The stock options of Distributing and Controlled II outstanding at the time of the distribution, and stock options of Distributing, Controlled I, Controlled II, and Controlled III that might be issued immediately after the distribution and within six months thereafter ("Stock Options") are or will be options to acquire stock in a corporation with customary terms and conditions provided to employees or directors in connection with the performance of services for the corporation or a person related to it under section § 355(d)(7)(A) (and that are not excessive by reference to the services performed) and that immediately after the distributions and within six months thereafter are nontransferable within the meaning of § 1.83-3(d) (other than with respect to certain limited transfers to family members for estate planning purposes permitted within the non-transferability requirements for eligibility for use of SEC registration Form S-8 which is designed for compensatory options) and do not have a readily ascertainable fair market value as defined in § 1.83-7(b).
- (o) Each 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% or more of the combined voting power of all classes of stock, or 50% or more of the total value of all classes of stock, of either Distributing or, respectively, Controlled I, II, or III. For each distribution, transactions that must be taken into account in assessing the correctness of this representation include the Issuances, the respective Offerings, and any other acquisitions or issuances of Distributing or Controlled I, II, or III stock, respectively (except as described in the next sentence) occurring within the period beginning on Date 1 and ending two years from the date of the

distributions (the "measurement period"), or occurring after the measurement period pursuant to an agreement made during such period. Any stock issued upon the exercise of the Stock Options either before or after the distributions will not be taken into account.

- (p) With respect to each distribution, neither Distributing nor Controlled I, II, or III will issue stock possessing, in the aggregate, 50% or more of the combined voting power of all classes of stock, or 50% or more of the total value of all classes of stock, of either Distributing or, respectively, Controlled I, II, or III within the measurement period. For each distribution, transactions that must be taken into account in assessing the correctness of this representation include the Issuances, the respective Offerings, and any other acquisitions or issuances of Distributing or Controlled I, II, or III stock, respectively (except as described in the next sentence) occurring within the measurement period, or after the measurement period pursuant to an agreement made during such period. Any stock issued upon the exercise of Stock Options either before or after the distributions will not be taken into account.
- (q) The reincorporation of Controlled II as a State X corporation will qualify as a reorganization under § 368(a)(1)(F) provided that it is ruled that the transactions described above concerning Controlled II will not prevent the reincorporation of Controlled II from qualifying as a reorganization under § 368(a)(1)(F).

Based solely on the information submitted and the representations set forth above, we hold as follows:

- (1) Distributing's transfer of its business 2, business 3, and business 4 assets to Controlled I, Controlled II, Controlled III, respectively, solely in exchange for all of the stock of Controlled I, II, and III, the Notes, and the assumption by the controlled corporations of certain liabilities, as described above, followed by the distribution of all of the Controlled I, II, and III stock to the Distributing shareholders will in each instance be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled I, II, and III will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of assets to Controlled I in exchange for Controlled I stock and the assumption by Controlled I of liabilities (§§ 357(a) and 361(a)).
- (3) Distributing will recognize gain (but not loss) upon the transfer of assets to, respectively, Controlled II and III in exchange for Controlled II and III stock, the Notes, and the assumption of liabilities, but only to the extent of the fair market value of the Notes (§ 361(b)).

- (4) Controlled I, II, and III will recognize no gain or loss on the receipt of the business 2, business 3, and business 4 assets, respectively, in exchange for the Controlled I, II, and III stock (§ 1032(a)).
- (5) The basis of each asset received by Controlled I will be the same as the basis of that asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (6) The basis of each asset received by Controlled II and III will be the same as the basis of that asset in the hands of Distributing immediately prior to the transaction increased by the amount of gain recognized by Distributing upon the transfers (§ 362(b)).
- (7) The holding period of the Distributing assets received by Controlled I, II, and III will include the period during which these assets were held by Distributing (§ 1223(2)).
- (8) The Distributing shareholders will not recognize gain or loss (and no amount will be included in the income of the Distributing shareholders) upon the receipt of the Controlled I, II, or III stock (§ 355(a)(1)).
- (9) Distributing will recognize no gain or loss upon the distribution of all of its Controlled I, II, III stock (§ 361(c)).
- (10) The aggregate basis of the Distributing stock and the Controlled I, II, and III stock in the hands of each of the Distributing shareholders immediately after the distributions will, in the aggregate, be the same as the basis of the of the Distributing stock in the shareholder's hands immediately prior to the distributions. Such aggregate basis will be allocated between the Distributing stock and the stock of Controlled I, II, and III in proportion to the relative fair market of each corporation's stock in accordance with § 1.358-2(a)(2) of the Income Tax Regulations (§ 358(b)(2)).
- (11) The holding period of the Controlled I, II, and III stock received by the Distributing shareholders will include the holding period of the Distributing stock with respect to which the distributions will be made, provided that the Distributing stock is held as a capital asset on the date of the distributions (§ 1223(1)).
- (12) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled I, II, and III will be made under § 1.312-10(a) of the regulations.
- (13) The transfer of assets by Distributing to Controlled II, Distributing's distribution of Controlled II stock, and the subsequent public offering of Controlled II stock will

not prevent the reincorporation of Controlled II from qualifying as a reorganization under § 368(a)(1)(F) (Rev. Rul. 96-29, 1996-1 C.B. 50).

- (14) Payments made between any of Distributing, Controlled I, II, or III or their subsidiaries under tax allocation agreements between them regarding tax liabilities that (i) have arisen or will arise for a taxable period ending before the distributions, or (ii) will not become fixed and ascertainable until after the distributions, will be treated as occurring immediately before the distributions.

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.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each affected taxpayer must attach a copy of this letter to the taxpayer's federal income tax return for the tax year in which the transaction covered by this ruling letter is consummated.

We have sent a copy of this letter to the taxpayer pursuant to the power of attorney on file in this office.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Michael J. Wilder

Michael J. Wilder

Assistant to the Chief, Branch 3