

**INTERNAL REVENUE SERVICE**

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August 3, 2000

Distributing =

Controlled =

Segment 1 =

Segment 2 =

Segment 3 =

Business A =

Business B =

State A =

Date 1 =

Subsidiary 1 =

Subsidiary 2 =

Subsidiary 3 =

p =

q =

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r =

s =

t =

This is in reply to a letter dated March 30, 2000, in which rulings were requested as to the federal income tax consequences of a proposed transaction. We have received additional information in letters dated June 5, June 30, July 11, and August 2, 2000. The information submitted for consideration is summarized below.

Distributing, a publicly held domestic corporation and parent of a consolidated group, is organized under the laws of State A. As of Date 1, p shares of Distributing common stock were outstanding. Attached to each share of common stock are certain preferred share purchase rights not exercisable or transferable separately from the Distributing stock unless and until certain events (generally involving changes in control) occur. No person holds five percent or more of Distributing's common stock. Distributing has no other class of stock outstanding. Distributing is authorized to issue preferred stock, but none is outstanding.

Distributing has three business segments, Segment 1, Segment 2 and Segment 3, and is directly engaged in businesses relating to those segments, including Business A and Business B. Financial information has been received indicating that each of Distributing's Business A and Business B have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Controlled is a newly formed wholly-owned subsidiary of Distributing organized under the laws of State A. Currently, Controlled is not engaged in any activities. In the Contribution (described below), Controlled will acquire Segment 2 from Distributing and will be directly engaged in Business B.

Subsidiary 1 is a wholly-owned subsidiary of Distributing organized in State A and Subsidiary 2 is a wholly-owned subsidiary of Subsidiary 1, also organized in State A. Subsidiary 2 was formed to hold and manage Distributing's portfolio of patents. Most of Distributing's patents and patent applications are held by Subsidiary 2, but some patents are held directly by Distributing.

Distributing's strategy has been to focus on high-growth businesses in the q sector. Segment 2, however, is a slower-growth business. Management of Distributing has determined that the separation of Segment 2 from the rest of Distributing's businesses will enable Distributing to sharpen its focus on the high-growth areas of its business while allowing Controlled, as a stand-alone company, to focus exclusively on Segment 2, which has different needs than Distributing's other businesses.

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To separate Segment 2, the taxpayer has proposed the following transaction (the "Transaction"):

- (i) Subsidiary 2 will transfer all its patents and patent applications to several newly-formed wholly-owned subsidiaries organized in State A (the "Patent Transfers" and each such subsidiary a "Patent Subsidiary"). The Subsidiary 2 patents and patent applications used predominantly in Segment 2 (the "Controlled Patents") will be transferred to Subsidiary 3.
- (ii) Immediately after the Patent Transfers, Subsidiary 1 will merge with and into Distributing in a transaction intended to qualify under § 368(a)(1)(A) (the "Subsidiary 1 Merger").
- (iii) Immediately after the Subsidiary 1 Merger, Subsidiary 2 will merge with and into Distributing in a transaction intended to qualify under § 368(a)(1)(A) (the "Subsidiary 2 Merger").
- (iv) Distributing will transfer to Subsidiary 3 all its patents and patent applications used predominantly in Segment 2 (the "Distributing Patent Transfer").
- (v) Distributing will contribute to Controlled the assets used predominantly in Segment 2, including Business B and the stock of Subsidiary 3 and Controlled will assume certain liabilities related to Business B (the "Contribution").
- (vi) In connection with the Contribution, Controlled will assume from Distributing \$r to \$s of borrowings under a debt facility of Distributing (the "Debt Assumption").
- (vii) Simultaneously with the Contribution, Distributing will transfer to Controlled certain other intangible property, including certain technology relating to Business B (the "Controlled Technology").
- (viii) Distributing will distribute to its shareholders 100 percent of the Controlled common stock in a ratio expected to be one share of Controlled common stock in respect of t shares of Distributing common stock (the "Distribution").
- (ix) After the Contribution, and either before or after the Distribution, Controlled may issue to one or more investors (the "Investors") in exchange for cash in a private placement (i) shares of Controlled common stock; (ii) shares of Controlled preferred stock; (iii) debt obligations of Controlled and/or (iv) warrants (the "Stock Issuance"). The Controlled preferred stock, the Controlled debt or the Controlled warrants will be convertible into a fixed number of shares of Controlled common stock at the option of the Investors. The amount of Controlled common stock into which the Controlled preferred stock, the Controlled debt, or the Controlled warrants is convertible, together with any Controlled common stock issued in the

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private placement, will be less than 20 percent of the outstanding Controlled common stock. If Controlled preferred stock is issued, it will be entitled to vote for directors of Controlled and will, together with any Controlled common stock issued in the private placement, represent less than 20 percent of the outstanding stock of Controlled, measured by both vote and value. If Controlled debt is issued, it will qualify as indebtedness for federal income tax purposes.

- (x) No fractional shares of Controlled common stock will be distributed in the Distribution to shareholders of Distributing, except in respect of fractional interests in Distributing held by certain of its employee benefit plans. The shares of Controlled common stock that would have been otherwise distributed as fractional shares to Distributing shareholders will be distributed to a distribution agent for those Distributing shareholders (the "Distribution Agent"), who will aggregate those fractional share interests and sell them in the public market. The proceeds of that sale will be paid pro rata to Distributing shareholders who would otherwise be entitled to fractional share interests in Controlled.

Distributing and Controlled will enter into several agreements relating to their separation, including transitional services agreements and a tax sharing agreement.

The following representations have been made in connection with the Contribution and the Distribution:

- (a) The indebtedness (if any) owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Distributing in the Distribution will be received by a shareholder as a creditor, employee or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing's Business A and Business B is representative of each business's present operations and, regarding each business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the Transaction, Distributing and Controlled will each continue the active conduct of Business A and Business B, respectively, independently and with their own separate employees.
- (e) The distribution will be carried out for the following business purpose: the separation of Segment 2 from the rest of Distributing's businesses will enable Distributing to sharpen its focus on the high-growth areas of its business while allowing Controlled, as a stand-alone company, to focus exclusively on Segment 2, which has different needs than Distributing's

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other businesses. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

- (f) 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 particular remaining shareholder or security holder of Distributing to sell, exchange, transfer by gift or otherwise dispose of any of their stock in, or securities of, either Distributing or Controlled after the Distribution.
- (g) 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.
- (h) 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 subsequent to the transaction, except in the ordinary course of business.
- (i) The total adjusted bases and fair market value of the assets to be transferred to Controlled by Distributing will each equal or exceed the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (j) The liabilities 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.
- (k) No investment credit has been or will be claimed with respect to any property being transferred between Distributing and Controlled.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to the distribution of the Controlled stock, except that Distributing may owe Controlled, or Controlled may owe Distributing, amounts payable for goods and services in the ordinary course of business or under certain transition contracts between the parties.
- (m) 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. Further, Distributing's excess loss account, if any, with respect to the Controlled common stock will be included in income immediately before the Distribution to the extent required by the applicable intercompany regulations.

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- (n) Apart from the cost-based transactions that represent transition services to facilitate the separation of Distributing and Controlled, payments made in connection with all continuing transactions 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.
- (o) No two parties to the Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (p) The payment of cash in lieu of fractional shares of Controlled is solely for the purpose of avoiding the expense and inconvenience of issuing fractional shares and does not represent separately bargained for consideration. 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.
- (q) The 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 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. Grants of compensatory options by Distributing and Controlled and the exercise of compensatory options will not be taken into account.
- (r) The Distributing share purchase rights and the Controlled share purchase rights are each the type of rights described in Rev. Rul. 90-11, 1990-1 C.B. 10.
- (s) Neither Distributing nor Controlled has been or will be a United States real property holding corporation ("USRPHC"), as defined in § 897(c)(2), at any time during the 5-year period ending on the date of the Distribution and neither Distributing nor Controlled will be a USRPHC immediately after the transaction.

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

- (1) The transfer by Distributing to Controlled of the assets described in step (v), above (the "Contribution"), solely in exchange for Controlled stock and the assumption of certain liabilities, as described above, followed by the

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distribution of all of Distributing's Controlled stock, pro rata, to Distributing's shareholders, will be a reorganization within the meaning of § 368(a)(1)(D) of the Code. Distributing and Controlled 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 (the "Contribution"), subject to liabilities (the Debt Assumption), to Controlled in exchange for the Controlled stock and the assumption of liabilities (§§ 361(a) and 357(a)).
- (3) Controlled will recognize no gain or loss on its receipt of assets in exchange for the Controlled stock, as described above (§ 1032(a)).
- (4) Controlled's basis in the assets received from Distributing will equal the basis of such assets in the hands of Distributing immediately prior to the transfer (§ 362(b)).
- (5) Controlled's holding period in the assets received from Distributing in the proposed transaction will include the period during which Distributing held such assets (§ 1223(2)).
- (6) Distributing will recognize no gain or loss upon its distribution of all of the Controlled stock (including any fractional share interests), pro rata, to Distributing's shareholders (§ 361(c)(1)).
- (7) The Distributing shareholders will recognize no gain or loss (and no amount will be included in their income) upon their receipt of the Controlled stock (including any fractional share interest to which they may be entitled) from Distributing (§ 355(a)(1)).
- (8) The aggregate basis of the Distributing and Controlled common stock in the hands of the Distributing shareholders immediately after the Distribution (including any fractional share interest to which they may be entitled) will equal the basis of the Distributing stock held immediately prior to the Distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2). See §§ 358(a), (b) and (c).
- (9) The holding period of the Controlled stock received by the Distributing shareholders (including any fractional share interest to which they may be entitled) will include the holding period of the Distributing stock with respect to which the distribution will be made, provided that the Distributing common stock is held as a capital asset on the date of the distribution (§ 1223(1)).

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- (10) Proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 1.312-10(a) and § 1.1502-33 of the Income Tax Regulations.
- (11) Shareholders of Distributing who receive cash from the Distribution Agent in respect of fractional shares of common stock will recognize gain or loss on the sale of the fractional share interest equal to the difference between the cash received and the holder's basis in such fractional share interest (§ 1001). Provided the fractional share interest is a capital asset in the hands of the exchanging shareholder, such gain or loss will be capital gain or loss to such holder.
- (12) Grants of compensatory options by Distributing or Controlled and exercises of compensatory options will not be taken into account for purposes of applying § 355(e).
- (13) The Stock Issuance will be taken into account for purposes of applying § 355(e) with respect to Controlled.

We express no opinion on the tax treatment of the 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 transaction that are not specifically covered by the above rulings. In particular, we express no opinion about (a) the Patent Transfers described above in step (i), (b) the Subsidiary 1 Merger described above in step (ii), (c) the Subsidiary 2 Merger described above in step (iii), (d) the Distributing Patent Transfer described above in step (iv), (e) the transfer of the Controlled Technology described above in step (vii), and (f) the cost-based transition services described in representation (n).

This ruling has no effect on any earlier document and is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax return of each affected taxpayer for the taxable year in which the transactions covered by this ruling letter are consummated.

Pursuant to a power of attorney on file in this office, we have sent a copy of this letter to your authorized representative.

Sincerely,  
Associate Chief Counsel (Corporate)

By: Ken Cohen

Acting Chief, Branch 3