

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:3-PLR-121194-00
Date:
April 3, 2001

Distributing =

Controlled =

Date 1 =

A =

B =

C =

D =

Segment 1 =

Segment 2 =

Date 2 =

Date 3 =

Date 4 =

E =

Bank =

This letter responds to a request dated September 29, 2000, for supplemental rulings with respect to a ruling letter dated August 3, 2000 (Control Number PLR-107632-00, LTR 200044019) (the "Prior Ruling"). Additional information was submitted in letters dated October 3, 2000, and January 30, February 8, and April 3, 2001. Except as modified herein, the facts and representations set forth in the Prior Ruling are still valid.

The Prior Ruling involved the contribution of certain assets to Controlled, followed by the distribution of the Controlled stock, pro rata, to the shareholders of Distributing (the "Contribution" and the "Distribution," respectively, and collectively, the "Transaction"). The Prior Ruling holds that the Transaction constitutes a tax-free reorganization under §§ 368(a)(1)(D) and 355 of the Code. The corporate business

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purpose for the Distribution was to 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. The Transaction was consummated on Date 1.

In connection with your request for the Prior Ruling, you indicated there would be no overlapping directors, officers, or employees of Distributing and Controlled, both of which are public corporations, after the Distribution. Since Date 1, however, unexpected developments at Distributing have led to the following changes:

- (i) Controlled proposes to appoint A, who has been an outside director of Distributing, to the Board of Directors of Controlled. A is a very experienced director of major corporations and institutions.
- (ii) On Date 2, Distributing's Board of Directors appointed B as Distributing's new Chairman and Chief Executive Officer (CEO) on a temporary basis, replacing C. B stepped down from B's position as Chairman of Controlled but will remain as a director of Controlled. Distributing has initiated an executive search for B's successor as Chairman and CEO of Distributing. It is likely, however, that B will remain on the Distributing Board of Directors after Distributing names B's successor.
- (iii) On Date 3, Controlled named D as Chairman of the Board to replace B. D is employed by Distributing to provide transitional consulting services relating to Distributing's Segment 1 business under a contract that will expire on Date 4. Under D's agreement with Distributing, D is permitted to act, and has acted, as an independent consultant to other companies in the E industry, if agreed to by Distributing.

The Prior Ruling includes the following representation:

- (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.

Section 4.05(1)(b)(iii) of Rev. Proc. 96-30 requires that stock repurchases be made in the open market.

Controlled is now considering instituting a stock repurchase program that would include open market purchases as well as derivatives transactions, such as puts and calls, with one or more investment or commercial banks. Controlled's stock repurchase program will meet the requirements of Rev. Proc. 96-30, with one possible exception. It is possible that, upon settlement of a derivatives transaction with a bank, Controlled will acquire Controlled Common Stock directly from a bank, and not on the open market.

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Under the terms of a sample forward contract between Bank and Controlled, in lieu of purchasing shares of Controlled Common Stock in the market, Controlled may enter into a forward contract to purchase shares of Controlled Common Stock from Bank at a fixed price on a specified date in the future. Controlled could elect to settle the forward contract at its maturity by purchasing those shares from Bank for the agreed price, or to have a "net settlement." In a net settlement, the market value of the shares under the contract is compared to the agreed purchase price of those shares; if the agreed purchase price is greater than the market value, Controlled would owe the difference to Bank, and if the market value is greater than the agreed purchase price, Bank would owe the difference to Controlled. The net settlement payment could be made in cash or in shares of Controlled Common Stock having a market value (at the time of settlement) equal to the amount owed by one party to the other. Thus, it is possible that Controlled could acquire shares of Controlled Common Stock by a regular settlement of the forward contract or, in certain cases, by the receipt of a net settlement payment from Bank.

In order to hedge its obligation to deliver Controlled Common Stock at the maturity of the forward contract (either in kind or in value), Bank might purchase Controlled shares in the open market. When buying those shares, Bank would be subject to the same provisions of the securities laws as Controlled would be subject to if Controlled were repurchasing its own shares on the open market.

In connection with its proposed stock repurchase program, Controlled has made the following representations:

- (a) There is a valid business purpose for the stock purchases.
- (b) The stock to be purchased is widely held.
- (c) The stock purchases will be made in the open market or, in certain cases, from one or more investment banks in connection with derivatives transactions between Controlled and such banks.
- (d) There is no plan or intention that the aggregate amount of stock purchases will equal or exceed 20 percent of the outstanding stock of Controlled.
- (e) Controlled will not know the identity of the seller of its stock with respect to any derivatives transaction in which it may participate.

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

None of the rulings issued in the Prior Ruling will be affected by (i) the continued service of A as a director of Distributing while A serves as a

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director of Controlled, (ii) the appointment of B as Chairman and CEO of Distributing on a transitional basis, or B's continued service as a director of Distributing thereafter, while B serves as a director of Controlled, (iii) the continuation of D's status as an employee of Distributing until the end of D's employment contract on Date 4 while D serves as Chairman of Controlled, or (iv) Controlled's repurchases of common stock pursuant to the proposed stock repurchase program.

This 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 taxpayer involved in the transaction should attach a copy of this letter to the taxpayer's federal income tax return for the taxable year in which the transaction is consummated.

Under a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely,
Associate Chief Counsel (Corporate)

By Ken Cohen

Senior Technician Reviewer, Branch 3