

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:1- PLR-163753-02

Date:  
March 21, 2003

RE:

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Corporation A =

Corporation B =

Corporation C =

Corporation D =

Corporation E =

Corporation F =

Corporation G =

Real Property =

Property Claim =

Business M =

Business N =

Business O =

c =

d =

e =

f =

g =

h =

i =

j =

k =

State X =

Dear

This letter responds to your letter dated November 14, 2002, in which rulings were requested as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated January 7 and March 13, 2003. The information submitted for consideration is summarized below.

Distributing is an accrual basis State X corporation and the common parent of an affiliated group of corporations (the "Distributing Group") that files a consolidated federal income tax return. Distributing is indirectly engaged in Business M and Business N through wholly owned Sub 1, which is directly and indirectly engaged in Business M and Business N. Distributing is also indirectly engaged in Business O through wholly owned Sub 2, which is directly engaged in Business O. Sub 1 owns all the stock (with de minimis exceptions) of various non-U.S. subsidiaries that are each actively engaged in Business M. Distributing also owns stock in the following companies: (1) approximately c% of the outstanding common stock of Corporation A; (2) approximately d% of the outstanding common stock of Corporation B; (3) approximately e% of the outstanding common stock of Corporation C; (4) approximately f% of the outstanding common stock of Corporation D; (5) all of the outstanding common stock of Corporation E; (6) all of the outstanding stock common of Corporation F; (7) an option to acquire g shares of the common stock of Corporation G; and (8) Real Property (all of the foregoing are collectively referred to as the "Non-Core Assets"). Distributing also owns an interest in certain potential litigation proceeds, a portion of which comprises the Property Claim.

Distributing has two classes of common stock outstanding: the "Common Stock," which is entitled to one vote per share and the "Class B Capital Stock," which is entitled to ten votes per share. The Class B Capital Stock is convertible into one share of the Common Stock at the option of the holder thereof. Distributing has outstanding approximately j shares of Common Stock and k shares of Class B Capital Stock.

Distributing owes approximately \$h to Sub 2 and also approximately \$i to banks under a revolving credit facility (the "Credit Facility"). Distributing and Sub 1 are the primary obligors on debt owed under the Credit Facility. The banks have security interests in the assets of Distributing and the Distributing Group, including the Non-Core Assets, the stock of Sub 2, and its assets. Prior to the proposed transaction, Sub 1 may become the sole obligor on the Credit Facility. The obligor (Distributing and/or Sub 1, as the case may be) will pay a fee to Controlled and Sub 2 for providing their respective guarantees for the Credit Facility. Controlled and Sub 2 will have a right to be reimbursed or indemnified by the obligor (Distributing and/or Sub 1, as the case may be) for any claims made upon them or their assets with respect to the Credit Facility. (The transactions described in the preceding three sentences are hereinafter collectively referred to as the "Guarantee Transactions.")

Financial information has been submitted indicating that Distributing (indirectly through Sub 1) and Controlled (indirectly through Sub 2) will each have had, immediately prior to the proposed distribution, gross receipts and expenses representative of the active conduct of a trade or business for each of the past five years.

Distributing has an immediate need to raise working capital for current operations and for growth and expansion of Sub 1's Business M and Business N operations. Distributing's investment banker opined that the proposed spin-off distribution of the Non-Core Assets and Business O will enable Distributing to raise significantly more capital

through a convertible debt offering, which will offer better repayment terms and less onerous financial covenants than exist under the current structure. In addition, the proposed distribution will allow Sub 2 to expand operations or acquire new businesses, which activities are currently prohibited under covenants in Distributing's Credit Facility that restrict Distributing from investing in business activities other than those of Business M and Business N. Accordingly, Distributing has proposed the following transaction:

(i) Distributing will transfer Non-Core Assets with a value of approximately \$h to Sub 2 in repayment of approximately \$h of debt owed by Distributing to Sub 2.

(ii) Distributing will then transfer the Property Claim, all of the Sub 2 stock and Non-Core Assets that are not either used to repay debt or sold in the Guarantee Release Transactions described below (the "Remaining Non-Core Assets") to Controlled in exchange for all of the common stock of Controlled (the "First Contribution").

(iii) Controlled will then transfer the Property Claim and the Remaining Non-Core Assets to Sub 2 in constructive exchange for Sub 2 stock (the "Second Contribution").

(iv) Distributing will then distribute all of the outstanding stock of Controlled to the stockholders of Distributing on a pro-rata basis. Each holder of Distributing Common Stock will receive one share of Controlled common stock for each share of Distributing Common Stock held and each holder of Distributing Class B Capital Stock will receive one share of Controlled common stock for each share of Distributing Class B Capital Stock held (the "Distribution"). Cash will be paid in lieu of fractional share interests in Controlled.

(v) Within one year of the Distribution, Distributing will issue debt to third party investors that is convertible into common stock of Distributing (the "Debt Offering") in order to raise a significant amount of capital.

To facilitate obtaining the ultimate release of Sub 2 and Controlled as guarantors of Distributing's indebtedness and to facilitate obtaining the release of the banks' security interest in the Non-Core Assets and the stock of Sub 2 and its assets, Distributing will repay part of its debt owed under the Credit Facility. Such payment will be funded out of (i) general funds of Distributing, (ii) proceeds from the sale of its shares in Corporation B stock, and/or (iii) loans to, or equity investments in, Distributing, by its existing shareholders, which loans or investments may occur before or after the Distribution. Repayment may also be funded out of the proceeds of the Debt Offering. Distributing may also sell some of the Non-Core Assets to Sub 2 in exchange for a promissory note of Sub 2, which would serve as collateral for the debt owed under the Credit Facility. (The transactions described in the preceding four sentences are hereinafter collectively referred to as the "Guarantee Release Transactions.") Distributing and Controlled will also enter into a distribution agreement, a transition service agreement, a tax sharing agreement, and other procedural agreements related to the implementation of the proposed transaction (the "Ancillary Agreements").

The following representations have been made in connection with the First Contribution (described in step (ii)), step (iv), and step (v) above:

(a) Any indebtedness between Distributing and Controlled after the Distribution will not constitute stock or securities.

(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 Distribution, at least 90% of the fair market value of the gross assets of Distributing will consist of stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2) of the Internal Revenue Code (the "Code").

(d) Immediately after the Distribution, at least 90% of the fair market value of the gross assets of Controlled will consist of stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in § 355(b)(2).

(e) The five years of financial information submitted on behalf of Sub 1 and Sub 2 are representative of each corporation's present operations, and with regard to each such corporation, there has been no substantial operational changes since the date of the last financial statements submitted.

(f) Following the Distribution, Distributing (indirectly through Sub 1) and Controlled (indirectly through Sub 2) will each continue the active conduct of its businesses independently and with its separate employees.

(g) The Distribution is to be carried out for the following corporate business purpose: to improve access to capital markets and raise funds through an issuance of convertible debt in order to fund operations, growth, and expansion. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(h) There is no plan or intention by any shareholder who owns 5% 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 to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the proposed transaction.

(i) 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 Distribution, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30.

(j) 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 and except for the transfer of the Remaining Non-Core Assets and the Property Claim to Sub 2.

(k) The total adjusted bases and the fair market values of the assets transferred to Controlled by Distributing in the First Contribution each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject (as determined under § 357(d)).

(l) The liabilities assumed by Controlled 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.

(m) No property is being transferred from Distributing to Controlled with respect to which any investment credit determined under § 46 has or will be claimed.

(n) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Distribution.

(o) Except for liabilities that might arise under the Ancillary Agreements, any guarantee by Controlled of Distributing's indebtedness, and the indemnification and reimbursement rights of Controlled against Distributing, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.

(p) 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). Furthermore, Distributing's excess loss account, if any, with respect to the stock of Controlled and any excess loss account with respect to any direct or indirect subsidiaries of Controlled that join in the filing of the Distributing Group's consolidated return will be included in income immediately before the Distribution (§1.1502-19).

(q) 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.

(r) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(s) 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 instead of issuing fractional shares of Controlled stock will not exceed 1% of the total consideration that will be issued pursuant to the Distribution. The fractional share interests will be aggregated, and no holder of Distributing common stock will receive cash in an amount greater than the value of one full share of Controlled stock.

(t) 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% or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50% or more of the total value of all classes of stock of either Distributing or Controlled.

(u) The Debt Offering will occur within 1 year after the Distribution.

The following representations have been made in connection with the Second Contribution described in step (iii) above:

(aa) No stock or securities will be issued for services rendered to or for the benefit of Sub 2 in the transaction, and no stock or securities will be issued for indebtedness of Sub 2.

(bb) Proceeds received in the collection of income items will be included as ordinary income in computing the taxable income of Sub 2.

(cc) The Second Contribution is not the result of the solicitation by a promoter, broker, or investment house.

(dd) Controlled will not retain any rights in the property transferred to Sub 2.

(ee) The value of Sub 2 stock received in exchange for accounts receivable will be equal to the net value of the accounts transferred (i.e., the face amount of the accounts receivable previously included in income less the amount of the reserve for bad debts).

(ff) The total adjusted bases and the fair market values of the assets transferred to Sub 2 by Controlled in the Second Contribution each equals or exceeds the sum of the liabilities assumed by Sub 2 plus any liabilities to which the transferred assets are subject (as determined under § 357(d)).

(gg) The liabilities assumed by Sub 2 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.

(hh) There is no indebtedness between Sub 2 and Controlled, and none will be created in favor of Controlled as a result of the transaction.

(ii) The Second Contribution will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.

(jj) All exchanges will occur on approximately the same date.

(kk) There is no plan or intention on the part of Sub 2 to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.

(ll) Taking into account any issuance of additional shares of Sub 2 stock; any issuance of stock for services; the exercise of any Sub 2 stock rights, warrants, or subscriptions; a public offering of Sub 2 stock; and the sale, exchange, transfer by gift, or other disposition of any Sub 2 stock received in the exchange, Controlled will be in "control" of Sub 2 within the meaning of § 368(c).

(mm) Controlled will receive stock of Sub 2 approximately equal to the fair market value of the property transferred to Sub 2.

(nn) Sub 2 will remain in existence and retain the property transferred to it in a trade or business.

(oo) There is no plan or intention by Sub 2 to dispose of the transferred property other than in the normal course of business operations.

(pp) Each of the parties will pay its own expenses, if any, incurred in the proposed transaction.

(qq) Sub 2 will not be an investment company under § 351(e)(1) and Treas. Reg. § 1.351-1(c)(1)(ii).

(rr) Controlled is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of § 368(a)(3)(A)) and the Sub 2 stock received in the exchange will not be used to satisfy the indebtedness of such debtor.

(ss) Sub 2 will not be a "personal service corporation" under § 269A.

Based solely on the information submitted and on the representations set forth above, it is held as follows:

(1) The First Contribution and the Distribution will, collectively, qualify as a "reorganization" within the meaning of § 368(a)(1)(D). 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 to Controlled in exchange for Controlled stock and any assumption of liabilities (§§ 361(a) and 357(a)).

(3) Controlled will recognize no gain or loss on the receipt of assets in exchange for Controlled stock and any assumption of liabilities (§ 1032(a)).

(4) Controlled's basis in each asset received from Distributing will be equal to the basis of such asset in the hands of Distributing immediately prior to the transfer of assets to Controlled (§ 362(b)).

(5) Controlled's holding period for each asset received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).

(6) Distributing will recognize no gain or loss upon the distribution of Controlled stock to the Distributing shareholders (§§ 361(c) and 355(c)).

(7) Distributing shareholders will recognize no gain or loss (and no amount will be included in the income of the Distributing shareholders) upon receipt of the Controlled stock (§ 355(a)(1)).

(8) The aggregate basis of the Distributing stock and the Controlled stock held by each Distributing shareholder will equal the aggregate basis of such shareholder's Distributing stock immediately before the Distribution, allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a)(2) (§ 358(a), (b) and (c)).

(9) The holding period of the Controlled stock received by Distributing's shareholders will include the holding period of the Distributing stock with respect to which the Distribution is made, provided that such Distributing stock is held as a capital asset on the date of the distribution (§ 1223(1)).

(10) Proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with Treas. Reg. §§ 1.312-10(a) and 1.1502-33(e).

(11) Payments made by Distributing to Controlled (or its subsidiaries) or by Controlled (or its subsidiaries) to Distributing under the tax sharing agreement (i) that have arisen or will arise for a taxable period beginning on or before and ending after the Distribution and (ii) that will not become fixed and ascertainable until after the Distribution will be treated as occurring immediately before the Distribution.

(12) The transfer by Distributing of certain Non-Core Assets to Sub 2 in satisfaction of debt owed by Distributing to Sub 2 will be treated as a separate taxable transaction that is not part of the § 368(a)(1)(D) reorganization or the Second Contribution.

(13) No gain or loss will be recognized by Controlled on its transfer of the Remaining Non-Core Assets and the Property Claim to Sub 2 pursuant to the Second Contribution in constructive exchange for stock of Sub 2 and any assumption of liabilities (§ 351(a)).

(14) Sub 2 will recognize no gain or loss on the receipt of assets in constructive exchange for Sub 2 stock and any assumption of liabilities (§ 1032(a)).

(15) The basis of the Sub 2 stock received by Controlled will be equal to the basis of the assets exchanged therefor, decreased by the amount of any assumed liabilities by Sub 2 to which the assets are subject (§ 358(a) and (d)).

(16) The basis of each asset received by Sub 2 will be the same as the basis of such assets in the hands of Controlled immediately prior to the transfer (§ 362(a)).

(17) The holding period of the assets received by Sub 2 will include the period during which such assets were held by Controlled immediately prior to the transfer (§ 1223(2)).

No opinion is expressed about the tax treatment of the transaction under other provisions of the Code and Income Tax 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. We specifically express no opinion regarding the tax treatment of the Guarantee Transactions or the Guarantee Release Transactions.

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

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

The rulings contained in this letter are predicated upon facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of the factual information, representations, and other data may be required as part of the audit process.

Pursuant to the power of attorney on file in this office, a copy is being sent to the taxpayer.

Sincerely,

By \_\_\_\_\_  
Michael J. Wilder  
Senior Technician Reviewer, Branch 1  
Associate Chief Counsel (Corporate)

CC: