

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID

No.

Telephone Number:

Refer Reply To:

CC:CORP:B03 – PLR-111787-03

Date:

October 23, 2003

Taxpayer =

Holding 1 =

Holding 2 =

State A =

State B =

Item =

Products =

\$m =

\$n =

o =

p =

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q =

r =

\$s =

\$x =

y =

\$z =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Effective Date =

Taxpayer's taxable year

Bankruptcy Court =

Dear :

We respond to your letter dated February 7, 2003, requesting a private letter ruling concerning the application of various sections of the Internal Revenue Code to Taxpayer's settlement of certain liabilities. The information in that request and in the subsequent correspondence of March 25, 2003, April 9, 2003, May 13, 2003, June 17, 2003, July 16, 2003, August 13, 2003, October 2, 2003, and October 20, 2003, is substantially set forth below.

Summary of Facts

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Taxpayer, a State A corporation, uses the accrual method of accounting, reports income on a calendar year basis, and is the wholly owned subsidiary of Holding 2, a State B corporation. Holding 2, Taxpayer, and its domestic subsidiaries are members of an affiliated group of corporations of which Holding 1, a State A corporation, is the common parent and join with Holding 1 in the filing of a consolidated federal income tax return.

Taxpayer and its subsidiaries are engaged in the design, manufacture and sale of Products. From Date 1 to Date 2, Taxpayer manufactured and sold Products, some of which contained Item, and distributed, installed or licensed its name to Products manufactured by other companies, some of which contained Item. As of Date 3, Taxpayer had been named as a defendant in numerous lawsuits claiming damages for personal physical injury, physical sickness, or death from exposure to Item that was included in Products. On Date 3, Taxpayer filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in order to obtain the court-supervised reorganization process and the provisions of §524(g) of the Bankruptcy Code to resolve the liability for the Item-related personal injury and wrongful death claims.

Taxpayer and its various creditors have agreed on the principal terms of a plan of reorganization (the Plan), and, on Date 4, Taxpayer filed the Plan with the Bankruptcy Court. Currently, Taxpayer is operating its business and managing its properties as a debtor in possession subject to the provisions of the Bankruptcy Code. Pursuant to provisions of the Bankruptcy Code, Taxpayer is not permitted to pay any claims or obligations that arose prior to Date 3 unless specifically authorized by the Bankruptcy Court. Similarly, claimants may not enforce any claims against Taxpayer that arose prior to Date 3 unless specifically authorized by the Bankruptcy Court. Taxpayer has made several non-substantive amendments to the Plan to date, which are encompassed within the reference to "Plan" herein.

Under the Plan, the existing capital stock of Taxpayer, which is held by Holding 2, will be cancelled. Holding 2 will receive new warrants (New Warrants) in the newly-issued common stock of reorganized Taxpayer (New Common Stock). In addition, on the Effective Date, initial awards of restricted shares of New Common Stock (Restricted Stock) and compensatory options to acquire New Common Stock (Compensatory Options) will be made to senior executive officers and a group of senior management of reorganized Taxpayer under the New Management Incentive Plan in the aggregate amount of p shares of Restricted Stock and q Compensatory Options, all of which will be subject to a vesting schedule. Taxpayer does not know to what extent, if any, elections will be made under §83(b) of the Internal Revenue Code with respect to the Restricted Stock.

In addressing the claims against Taxpayer, many classes of impaired and unimpaired claims have been designated, including but not limited to, (1) unsecured

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convenience claims, which will be paid r percent of their allowed amount in cash in satisfaction and discharge (Convenience Claims), (2) unsecured claims other than convenience claims (the Unsecured Claims), (3) property damage claims, and (4) personal injury claims.

Property Damage Claims: An Item-related property damage claim includes, in general, any claim against Taxpayer existing or arising in the future for damages to property arising from the installation or presence of Products containing Item that were sold or provided by Taxpayer or through an entity for which Taxpayer is liable. An Item-related property damage claim does not include an Item-related personal injury claim.

Taxpayer has reached a global settlement with the holders of property damage claims, which has been approved by the Bankruptcy Court.

Personal Injury Claims: An Item-related personal injury claim includes, in general, any claim against Taxpayer existing or arising in the future for death, bodily injury, sickness, disease, or other personal injuries caused by the exposure to Item or Item-containing Products sold, distributed or installed by Taxpayer directly or through an entity for which Taxpayer is otherwise liable. It also encompasses any claim under any settlement entered into by or on behalf of Taxpayer prior to the Date 3 of the Plan relating to an Item-related personal injury claim, including compensatory and punitive damages. An Item-related personal injury claim does not include an Item-related property damage claim or a workers' compensation claim.

The Item-related personal injury claims will be addressed through the funding of a trust (the PI Trust), which will receive in the aggregate, in satisfaction and discharge of all personal injury claims, a package consisting of cash, new notes of reorganized Taxpayer, if issued (the Plan Notes), New Common Stock, and Taxpayer's rights under certain insurance policies and related assets. It is likely, although not certain, that the New Common Stock will be publicly traded as of the date of issuance to the PI Trust. The PI Trust's payments to claimants will be made for personal physical injuries or physical sickness pursuant to §104(a). There is no dollar limit to Item-related personal injury claims that may be filed with the PI Trust because the claimants were excused from filing a formal claim with the Bankruptcy Court. However, Taxpayer's expected liability for present and future Item-related personal injury claims is at least \$z.

Specifically, under the Plan, the PI Trust and the holders of the Unsecured Claims will receive all of the New Common Stock to be issued on the Effective Date (other than the New Common Stock issued to management, as discussed above), which represents all of the capital stock of reorganized Taxpayer, the Plan Notes (expected to be worth face value) in an aggregate amount of \$s, and all available cash (which is expected to be approximately \$x) as of the Effective Date. The full amount transferable to the PI Trust is anticipated to be approximately y percent (more than 50

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percent) of the New Common Stock, the Plan Notes, and the available cash of Taxpayer.

In connection with funding the PI Trust, Taxpayer plans to undertake reasonable efforts to effect private placements of new debt, denominated as 144A Debt Securities, on or as soon as practicable after the Effective Date (the 144A Offering). To the extent these offerings are successful, the net cash proceeds will be transferred to the PI Trust and the holders of Unsecured Claims in lieu of an equal amount of Plan Notes. In addition, an amendment to the Plan requires Taxpayer to use its reasonable efforts to borrow additional monies to fund the shortfall, to the extent the private placements yield insufficient proceeds to dispense with the Plan Notes. Thus, the Plan as modified increases the likelihood that the Plan Notes will not be issued. In the event 144A Debt Securities are issued but there remains some amount of Plan Notes to be issued, the Plan as modified requires that the Plan Notes take the form of additional 144A Debt Securities or, at least, have substantially the same terms and conditions. The transfer to the PI Trust of its share of any net cash proceeds from the 144A Offering will not occur until after the Effective Date.

In contrast to the transfer date of the cash proceeds from the 144A Offering, all other cash amounts required to be transferred to the PI Trust (i.e., available cash which is expected to be approximately y percent of \$x) are expected to be transferred on the Effective Date. Similarly, the New Common Stock will be transferred to the PI Trust at its inception.

Under the Plan, the PI Trust will assume all liability and responsibility for all personal injury claims and will be the sole recourse of the holder of an Item-related personal injury claim. Also, Taxpayer will be discharged and have no further financial or other responsibility or liability for such claims. Additionally, in order to comply with Bankruptcy Code provisions, only cash distributions will be made from the PI Trust to personal injury claimants in payment and satisfaction of their claims. Accordingly, no portion of the New Common Stock and Plan Notes, if any, received by the PI Trust will be distributable to the personal injury claimants. Any assets remaining in the PI Trust after satisfaction of all allowed claims will be delivered and conveyed to one or more tax-exempt charitable organizations, not bearing any relationship to Taxpayer, selected by the PI Trustees, although Taxpayer does not anticipate that any assets will remain in the trust after satisfaction of all allowed Item-related personal injury claims.

On the Effective Date, Taxpayer and its subsidiaries will be disaffiliated from, and no longer members of, the old consolidated group (the Old Group). The taxable year of Taxpayer and its subsidiaries will terminate as of the end of the Effective Date, and Taxpayer will become the common parent of a new affiliated group composed of Taxpayer and its subsidiaries (the New Group). Taxpayer and its subsidiaries intend to

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join in the filing of a new consolidated federal income tax return commencing the date after the Effective Date.

Under the Plan, the Bankruptcy Court will retain exclusive jurisdiction over any matter arising in or relating to the Chapter 11 case or the Plan. This includes matters relating to interpreting, enforcing and administering the terms of the PI Trust Agreement.

Taxpayer Representations

- (a) Taxpayer and its subsidiaries (to the extent still subsidiaries of Taxpayer immediately following the Effective Date) will join in the filing of a consolidated federal income tax return for the taxable year commencing the day after the Effective Date.
- (b) On the Effective Date, Taxpayer will undergo an “ownership change” within the meaning of §382(g)(1) and applicable regulations as a result of the implementation of the Plan.
- (c) Taxpayer has not yet decided whether to make an election under §382(l)(5)(H) in respect of the ownership change resulting from the implementation of the Plan.
- (d) Taxpayer will obtain a “qualified appraisal” within the meaning of §1.468B-3(b) of the Income Tax Regulations with respect to the fair market value of the New Common Stock issued to the PI Trust, assuming such stock is a “nonpublicly traded security” within the meaning of the regulations.
- (e) Taxpayer will, on a timely basis, provide the Internal Revenue Service and the PI Trust with the statement required under §1.468B-3(e) and will include such statement in its tax return for the taxable year in which the funding of the PI Trust occurs.
- (f) Following the funding of the PI Trust, neither Taxpayer nor any “related person” to Taxpayer within the meaning of §468B(d)(3) will own at any time, directly or indirectly, any beneficial interest in the corpus or income of the PI Trust.
- (g) Following the funding of the PI Trust, no beneficiary of the PI Trust will own (within the meaning of §382) 5 percent or more of the capital stock of Taxpayer, taking into account only such person’s beneficial interest in the PI Trust.

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- (h) The New Warrants, Compensatory Options, and Restricted Stock that are outstanding or granted as of the Effective Date will be subject to the entrepreneurial risks of Taxpayer's corporate business operations.

Rulings

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

With respect to the taxation of the PI Trust:

- (1) The PI Trust will satisfy the requirements of a qualified settlement fund (QSF) under §1.468B-1 when approved by the Bankruptcy Court, funded, and its assets are segregated from the other assets of Taxpayer.
- (2) The initial basis in all property (other than cash) received by the PI Trust from Taxpayer (including New Common Stock, Plan Notes, and any other assets) will be the fair market value of such property on the date of transfer pursuant to §1.468B-2(e).
- (3) The PI Trust will be subject to tax on its modified gross income for any taxable year at a rate equal to the maximum rate in effect for that taxable year under §1(e). Therefore, upon the sale, exchange, or other taxable disposition by the PI Trust of any trust asset (including, without limitation, the New Common Stock and the Plan Notes), the PI Trust generally will recognize gain or loss equal to the difference between the fair market value of the disposed asset and its adjusted basis in such asset.
- (4) The PI Trust is not required to file information returns under §6041 for the payments made for personal physical injuries or physical sickness pursuant to §104 (a).

With respect to the taxation of Taxpayer in connection with the funding of the PI Trust and the discharge of claims:

- (5) Taxpayer will not recognize any gain or loss on its stock in exchange for the satisfaction of its debts to the personal injury claimants through the PI Trust (§1032).
- (6) Taxpayer will not recognize any gain or loss upon the transfer of the Plan Notes to the PI Trust (§1.468B-3(a)(1)).

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- (7) Once the PI Trust satisfies all the requirements necessary to become a QSF, Taxpayer will be entitled to deduct under §162 the amount of cash (other than amounts representing insurance policy proceeds Taxpayer recovered but excluded from gross income) transferred to the PI Trust, in the taxable year during which the cash payments are made. Further, Taxpayer will be allowed to deduct under §162 an amount equal to the fair market value of the New Common Stock transferred to the PI Trust, in the taxable year during which such New Common Stock is transferred to the PI Trust. However, no deduction will be allowed for the issuance of the New Common Stock unless the qualified appraisal requirements of §1.468B-3(b) are satisfied, if applicable.
- (8) Taxpayer will be entitled to deduct, under §162, the principal payments made on the Plan Notes transferred to the PI Trust in the tax year Taxpayer makes such principal payments.
- (9) Taxpayer will not realize discharge of indebtedness income from its settlement of the Item-related tort (§108(e)(2)).

With respect to §382:

- (10) Solely for purposes of determining whether Taxpayer is qualified for treatment under the provisions of §382(l)(5)(A), shares of New Common Stock transferred by Taxpayer to the PI Trust will be treated as transferred to and owned by persons who are beneficiaries of the PI Trust on the date of Taxpayer's transfer. This ruling applies whether or not such persons were identified or identifiable at the time of Taxpayer's transfer.
- (11) When the PI Trust sells the New Common Stock, Taxpayer will undergo a subsequent ownership change when the provisions of §382(g) are met. Taxpayer will not qualify for §382(l)(5) treatment with respect to the subsequent ownership change if such change occurs during the 2-year period immediately following the Effective Date. The subsequent payment of cash by the PI Trust in satisfaction of the personal injury claims will not be considered a segregation event within the meaning of §1.382-2T(j)(2) or otherwise result in an owner shift within the meaning of §§ 382(g)(2) and 1.382-2T(e) with respect to Taxpayer.
- (12) The deduction attributable to the transfer of New Common Stock and cash to the PI Trust on the Effective Date will be allocated to the pre-change period (§382(d)(1) and §1.382-6(g)(2)).

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- (13) The deduction allowable for the transfer of New Common Stock and cash to the PI Trust on the Effective Date is not treated as a recognized built-in loss under §382(h)(6)(b), and will not be taken into account in determining net unrealized built-in gain or net unrealized built-in loss on the Effective Date.
- (14) Section 382(h)(4) will not limit Taxpayer's ability to carry back to a prior taxable year any portion of the deduction attributable to the transfer of New Common Stock and cash to the PI Trust.
- (15) New Warrants, Compensatory Options, and Restricted Stock that are outstanding or granted as of the Effective Date may be included in determining the value component of the annual limitation under §1.382-9(j), to the extent these items have value.

With respect to consolidation:

- (16) The general end of the day rule, rather than the next day rule, will apply to the deduction attributable to the transfer of New Common Stock and cash to the PI Trust, and the deduction should be included in the consolidated return of the Old Group under §1.1502-76(b)(1)(ii) on the Effective Date.
- (17) Pursuant to §1504(a)(3)(B), §1504(a)(3) does not prevent the New Group from filing a consolidated return beginning the day after the Effective Date.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Particularly, this office has not reviewed any valuation figures or the valuation methodology used by Taxpayer with respect to the valuation of the New Warrants, Compensatory Options, and Restricted Stock. Therefore, no opinion is expressed regarding any assigned values or the valuation methodology employed by the Taxpayer with respect to the New Warrants, Compensatory Options, and Restricted Stock.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the

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material submitted in support of the request for rulings, it is subject to verification on examination.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Filiz Serbes
Chief, Branch 3
Office of Associate Chief Counsel
(Corporate)