Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
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Distributing =

Controlled =

State X =
State Y =

Business 1 =
Business 2 =

Investor 1 = .
Investor 2 =
Investor 3 =
Investor 4 =

Corporation A =
Corporation B =
Corporation C =
Corporation D =
Corporation E =
Corporation F =
Corporation G =

Subsidiary 1 =
Subsidiary 2 =

Purchaser 1 =
Purchaser 2 =
Purchaser 3 =

Partnership 1 =

LLC 1 =

$X =

$Y =

a =

b =

c =

d =

e =

f =

g =

Year 1 =

Date 1 =

Dear:

This is in response to your letter dated March 30, 2000, in which you requested rulings on the federal income tax treatment of the transactions described below. Specifically, you requested rulings under § 355 of the Internal Revenue Code and other related Code sections. Additional information regarding your request has been submitted in subsequent letters. The information submitted for our review is summarized below.

Distributing, a publicly-traded State Y corporation, has been engaged for more than five years in two businesses, Business 1 and Business 2. Investors 1, 2, 3 and 4, all institutional investors, own 5% or more of Distributing. Distributing, a holding company, indirectly conducts Business 2 through four wholly-owned domestic corporations, Corporations A, B, C and D. Corporations A, B and C directly engage in Business 2. Corporation D indirectly engages in Business 2 through two partnerships, Partnership 1 and LLC 1. LLC 1, a limited liability company for state purposes, has elected to be treated as a partnership for federal income tax purposes. The current structure of the business conducted by Corporation D was created in Year 1 when Distributing transferred Business 2 assets to Corporation D which then transferred the assets to the partnerships in transactions in which no gain was recognized.

Partnership 1 owns LLC 1, which directly engages in Business 2. Corporation D is a limited partner in Partnership 1 and owns a% (more than 80%) of the partnership. Subsidiary 1, a wholly-owned subsidiary of Corporation A, owns b% of Partnership 1.

Distributing owns the remaining interest in Partnership 1, c%, and is the sole general partner of the partnership. The taxpayer has provided information that Distributing has been engaged in active and substantial management functions of Partnership 1 for more than five years.

Partnership 1 also currently owns d% (more than 90%) of LLC 1. Corporation E, a wholly-owned subsidiary of Distributing, owns e% of LLC 1. Corporation F, a corporation unrelated to Distributing and its subsidiaries, own f%, the remaining interest in LLC 1.

LLC 1 is managed through an operating agreement which provides that the management of the partnership is vested in its members through a board of four directors, three of whom are appointed by Partnership 1 and one by Corporation F. The three members appointed by Partnership 1 are employees of Distributing. The taxpayer has provided information that Distributing, through its employees, has been engaged in active and substantial management functions of LLC 1 for more than five years.

Distributing now wants to separate its Business 2 from Business 1 because Distributing has concluded that the two businesses are no longer compatible and the separation will facilitate and promote greater management focus and resolve disputes in setting corporate objectives and allocations and in satisfying customer demands for pure play businesses. The taxpayer has supplied internal memos detailing these conflicts as well as analysis from a third-party investment banker on those issues. Distributing intends to separate the two businesses in the following transactions:

(1) Distributing sold Subsidiary 2 to Purchaser 1 and Purchaser 2 for $X. Distributing also sold certain assets related to Business 1 to Purchaser 3 for $Y.

(2) Distributing will transfer the stock of Corporations A, B, C and D and its general partnership interest in Partnership 1 (the Business 2 assets) to Controlled, a State X corporation formed to facilitate this transaction, in exchange for all of Controlled stock.

(3) Controlled will acquire (at fair market value) from Corporation E the interest in LLC 1 owned by Corporation E and will transfer that interest to Corporation D. Controlled will also transfer its general partnership interest in Partnership 1 to Corporation D.

(4) The stock of Controlled will then be transferred pro rata to Distributing's shareholders. No fractional shares will be issued in the transaction; instead, cash will be issued in exchange for fractional share interests.

(5) Following the distribution of Controlled, Controlled intends to acquire certain assets of Corporation G in exchange for g% of its stock.

The following additional representations have been made in connection with the 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 is representative of the present operations of the business, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

(c) The five years of financial information submitted on behalf of Corporation A and Corporation D (the Controlled active business) is representative of the business' present operations, and with regard to that business, there have been no substantial operational changes since the date of the last financial statements submitted.

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

(e) Following the distribution, Distributing and Controlled (through Corporations A and D) will each continue the active conduct of its business independently and with its separate employees.

(f) The distribution of the stock of Controlled is carried out for the purpose of enhancing management focus on both Distributing and Controlled and alleviating systemic problems that have arisen due to the disparity of the two businesses. The distribution is motivated, in whole or substantial part, by this corporate business purpose.

(g) There will be no common directors, officers, employees, or common property between Controlled and Distributing (and neither Distributing nor Controlled will provide goods or services to the other) after the distribution, except that the Chairman of the Board of Distributing will serve as the Chairman of Controlled's board of directors until Date 1.

(h) 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 section 4.05(1)(b) of Rev. Proc. 96-30.

(i) Except for the sale of Subsidiary 2 and certain assets related to Business 1, as described in step 1 above, 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 distribution, except in the ordinary course of business.

(j) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled.

(k) 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, if Distributing had an excess loss account with respect to its Controlled stock immediately before the distribution, the excess loss account will be taken into account at that time.

(l) Payments made in connection with all continuing transactions, if any, 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.

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

(n) The gross assets of the trades or businesses that will be relied upon by Distributing and Controlled to satisfy the active trade or business requirement of § 355(b) will, in aggregate, have a fair market value that is not less than five percent of the total fair market value of the gross assets of the company directly operating such trades or businesses.

(o) The distribution will not be a disqualified distribution within the meaning of § 355(d)(2) because, during the five-year period ending on the date of the distribution and immediately after the distribution, no person has held, nor will hold, disqualified stock of either Distributing or Controlled which constitutes a 50% or greater interest in either corporation.

(p) 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.

(q) Any payment of cash in lieu of fractional shares of Distributing and Controlled is solely for the purposes of avoiding the expense and inconvenience to Distributing and Controlled of issuing fractional shares and does not represent separately bargained for consideration. The share interests of each shareholder

of Distributing and Controlled will be aggregated and no shareholder will receive cash in an amount equal to or greater than the value of one full share of either Distributing or Controlled stock. The total amount of cash paid in lieu of fractional shares will not exceed one percent of the fair market value of either Distributing or Controlled stock.

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

(1) The transfer by Distributing to Controlled of the stock of Corporations A through D, and of Distributing's partnership interest in Partnership 1 in exchange for all the stock of Controlled, followed by the distribution of the Controlled stock pro rata to Distributing's shareholders will be a reorganization within the meaning of section 368(a)(1)(D) of the Code. Distributing and Controlled each will be a "party to the reorganization" within the meaning of section 368(b) of the Code.

(2) No gain or loss will be recognized by Distributing as a result of the transfer of the Business 2 assets to Controlled in exchange for the stock of Controlled. § 361(a).

(3) No gain or loss will be recognized by Controlled upon the receipt of the Business 2 assets from Distributing in exchange for the stock of Controlled. § 1032(a).

(4) The basis of each of the Business 2 assets received by Controlled in the transaction will equal the basis of such assets in the hands of Distributing immediately prior to their transfer to Controlled. § 362(b).

(5) The holding period of each of the Business 2 assets to be received by Controlled in the transaction will include the period during which such assets were held by Distributing. § 1223(2).

(6) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of Controlled. § 361(c)(1).

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

(8) The aggregate basis of the stock of Distributing and Controlled in the hands of the shareholders of Distributing immediately following the distribution will be the same as the basis in their Distributing stock held immediately before the distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2). § 358(b)(2).

(9) The holding period of the Controlled stock received by the shareholders of

Distributing will include the holding period of the Distributing stock on which the distribution is made provided that such stock was held as a capital asset on the date of the proposed transaction. § 1223(1).

(10) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a) and § 1.1502-33.

(11) Any payment of cash in lieu of a fractional share interest in Controlled will be treated for federal income tax purposes as if the fractional share interest had been issued in the distribution and then redeemed by Controlled. The cash payment will be treated as having been received in exchange for the constructively redeemed fractional share under section 302(a).

No opinion is expressed 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 transactions that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6610(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 returns of the taxpayers involved for the taxable year in which the transactions covered by this ruling is consummated.

Sincerely Yours,
Associate Chief Counsel (Corporate)
By: Christopher W. Schoen
Assistant to the Chief, CC:CORP:1