## Internal Revenue Service

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Person to Contact:
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Distributing =

Controlled =

Acquiring =

Acquiring Shareholder =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5
$=$

Sub 6 =

Sub 7 =

Sub 8 =

Sub 9 =

Sub 10
$=$

Sub 11
$=$

Sub 12
$=$

A

B

C
$=$

D

| Business A | $=$ |
| :--- | :--- |
| Business B | $=$ |
| Asset C | $=$ |

Asset D =
Asset E =

| Date A | $=$ |
| :--- | :--- |
| Date B | $=$ |
| $\underline{\mathrm{a}}$ | $=$ |
| $\underline{\mathrm{b}}$ | $=$ |


| $\underline{C}$ | $=$ |
| :--- | :--- |
| $\underline{\mathrm{d}}$ | $=$ |


| $\underline{\mathrm{e}}$ | $=$ |
| :--- | :--- |
| $\underline{\mathrm{f}}$ | $=$ |
| g | $=$ |
| $\underline{\mathrm{h}}$ | $=$ |

i =
i =
k =

Federal Agency rules =

Dear
We respond to your letter dated July 2, 1998 requesting rulings on certain federal income tax consequences of a series of proposed transactions.

## Summary of Facts

Distributing is the common parent of an affiliated group of corporations that files a consolidated federal income tax return (the "Distributing Group"). Distributing wholly owns Sub 1, Sub 2, Sub 3, Sub 4, Sub 5, Sub 6, Sub 10, and Sub 11. Sub 6 wholly owns Sub 7, Sub 8, Sub 9, and Sub 12.

Distributing has two classes of stock outstanding, publicly traded common stock (the "Distributing Common Stock") and nonpublicly traded class B common stock (the "Distributing Class B Common Stock"). Each share of Distributing Common Stock is entitled to a votes, and each share of Distributing Class B Common Stock is entitled to $\underline{b}$ votes. Of the Distributing stock outstanding on Date A, the Distributing Common Stock represented $\underline{c}$ percent of the combined voting power and $\underline{d}$ percent of the equity value, and the Distributing Class B Common Stock represented e percent of the combined voting power and $\underline{f}$ percent of the equity value. A, B, C and D are the only five percent shareholders of Distributing (the "Five Percent Shareholders").

Distributing conducts Business A directly through Asset C and indirectly through Sub 1, Sub 2, Sub 3, Sub 4, and Sub 5. Distributing conducts Business B through Sub 6, Sub 7, Sub 8, and Sub 9. Financial information has been received which indicates that Distributing's Business A and Business B each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Publicly traded Acquiring conducts Business B through wholly owned subsidiaries. Acquiring has four classes of stock outstanding, including series A common stock (the "Acquiring Common Stock") and series B common stock. As of Date B, Acquiring Shareholder (through a wholly-owned subsidiary) owned $g$ percent of the Acquiring common stock.

## Proposed Transactions

Acquiring wishes to acquire the Business B operations of Distributing but has no interest in Business A. To accommodate Acquiring, Distributing proposes the following series of transactions (the "Transactions"):
(i) Distributing has formed wholly owned Controlled to facilitate the Transactions.

The outstanding stock of Controlled will consist of common stock with a votes per share (the "Controlled Common Stock") and class B common stock with $\underline{b}$ votes per share (the "Controlled Class B Common Stock").
(ii) Distributing will borrow $\underline{h}$ dollars from an unrelated third party lender, the debt to be secured by the Business B assets (the "New Debt").
(iii) Distributing will apply part of the New Debt proceeds to (a) repay its existing indebtedness (including any accrued and unpaid interest thereon and any applicable prepayment penalties or premiums), (b) pay all amounts owed to employees of Distributing Group members pursuant to certain employment and participation agreements, (c) pay all amounts resulting from cancellation of Distributing's outstanding employee stock options, and (d) pay all other out-of-pocket costs and expenses incurred in the Transactions, such as commitment fees payable to the New Debt lender and fees and expenses owed those advising on the Transactions (collectively, the "Deal Expenses").
(iv) Sub 6 will distribute Sub 12 to Distributing.
(v) Distributing will contribute to Controlled the Business A assets (including Asset C and Subs 1 through 5), Sub 10, Sub 11, Sub 12, and id dollars of cash and cash equivalents (including the balance of the New Debt proceeds remaining after payment of the Deal Expenses) in exchange for the stock of Controlled and the assumption by Controlled of liabilities associated with Business A (the "Contribution").
(vi) Distributing will distribute one share of the Controlled Common Stock to the holder of each share of Distributing Common Stock and one share of Controlled Class B Common Stock to the holder of each share of Distributing Class B Common Stock (the "Distribution").
(vii) Within five business days after the Distribution, Distributing will merge into Acquiring under state law (the "Merger") in a transaction the taxpayer represents will qualify under $\S 368(\mathrm{a})(1)(\mathrm{A})$ of the Internal Revenue Code. As a result, the Distributing shareholders will exchange their Distributing Common Stock and Distributing Class B Common Stock for Acquiring Common Stock. Acquiring will pay cash to the Distributing stockholders in lieu of issuing fractional shares of Acquiring Common Stock.

Acquiring and Controlled have agreed to indemnify each other for certain securities law, tax, and others matters (the "Indemnification Payments").

## Representations

Distributing, Controlled, and Acquiring have made the following representations regarding the Transactions:
(a) Any indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
(b) No part of the consideration 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 represents its present operation, and with regard to Business A, there have been no substantial operational changes since the date of the last financial statements submitted.
(d) Immediately after the Distribution, the gross assets of the business directly conducted by Controlled (as defined in $\S 355(\mathrm{~b})(2)$ ) will have a fair market value equal to at least five percent of the total fair market value of the gross assets of Controlled.
(e) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock of Sub 6, which is engaged in the active conduct of a trade or business as defined in § 355(b)(2).
(f) Immediately after the Distribution, the gross assets of the business directly conducted by Sub 6 (as defined in § 355(b)(2)) will have a fair market value equal to at least five percent of the total fair market value of the gross assets of Sub 6.
(g) The five years of financial information submitted on behalf of Subs 6 through 9 represents their present operation, and with regard to Business $B$, there have been no substantial operational changes since the date of the last financial statements submitted.
(h) Following the Distribution and Merger, Acquiring will continue the active conduct of Business B through wholly owned Sub 6 (and its subsidiaries), and Controlled will continue the active conduct of Business A, independently and with its separate employees.
(i) The Distribution will be carried out to facilitate the acquisition of Distributing's Business B operations by Acquiring pursuant to the Merger and for other reasons. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
(j) There is no plan or intention by any of the Five Percent Shareholders, 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 stock in, or securities of, Distributing, Acquiring, or Controlled after the Distribution, other than in the Merger,
except for possible dispositions by one or more Five Percent Shareholders consisting of (i) gifts of Acquiring or Controlled stock to charitable organizations, charitable trusts, or charitable split-interest trusts (the non-charitable beneficiary or beneficiaries of which is the donor Five Percent Shareholder or one or more family members (as defined in § 267(c)(4)) of the Five Percent Shareholder), (ii) gifts of Acquiring or Controlled stock for estate planning purposes to one or more family members (as defined in § 267(c)(4)) of the Five Percent Shareholder or to entities if the Five Percent Shareholder is considered under the constructive ownership rules of
§ 267(c) to own Acquiring or Controlled stock owned by such entity, and (iii) simultaneous sales of the Five Percent Shareholder's Acquiring stock and Controlled stock in amounts that represent equal proportions of the Acquiring stock and Controlled stock received by the Five Percent Shareholder in the Transactions, provided that all dispositions described in the foregoing clauses (i), (ii) and (iii) by the Five Percent Shareholders will not exceed in the aggregate the number of shares of stock of either Acquiring or Controlled having a fair market value, immediately following the Transactions, equal to j percent of the fair market value of all of such corporation's outstanding stock at such time.
(k) There is no plan or intention by Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Distribution and Merger, other than through stock purchases meeting the requirements of $\S 4.05(1)(b)$ of Rev. Proc. 96-30, 1996-1 C.B. 696, 705. Further, there is no plan or intention by Acquiring or Acquiring Shareholder, directly or through any subsidiary corporation, to purchase any of Acquiring's outstanding stock after the Distribution and Merger, other than through stock purchases that, in the aggregate, meet the requirements of $\S 4.05(1)(\mathrm{b})$ of Rev. Proc. 96-30 or in private transactions from persons who were stockholders of Acquiring before the Merger.
(I) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation (apart from the Merger), or to sell or otherwise dispose of the assets of either corporation after the Distribution, except in the ordinary course of business and except for a possible sale or exchange of Asset D to comply with certain Federal Agency rules, and for the possible sale or exchange of Asset E . Asset D and Asset E have an aggregate value of less than k percent of the value of Distributing's Business B assets.
(m) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.
(n) The liabilities assumed by Controlled in the Contribution 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.
(o) The income tax liability for the taxable year in which investment credit property (including any building to which $\S 47(\mathrm{~d})$ applies) is transferred will be adjusted pursuant to §50(a)(1) or (a)(2) (or § 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
(p) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution, other than possible indebtedness for Indemnification Payments.
(q) 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 of the Income Tax Regulations as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, any excess loss account Distributing may have in the Controlled stock will be included in income immediately before the Distribution to the extent required by the applicable intercompany transaction regulations (see §1.1502-19).
(r) Payments made in any continuing transactions between Distributing, Acquiring, and Controlled or any of their respective affiliates will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
(s) No two parties to the Transactions are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
(t) The Merger will qualify as a reorganization under § 368(a)(1)(A).

## Rulings

Based solely on the information submitted and representations set forth above, we rule as follows:
(1) The Contribution, followed by the Distribution, will be a "reorganization" under § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" under § 368(b).
(2) No gain or loss will be recognized by Distributing on the Contribution (§§ 361(a) and 357(a)).
(3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).
(4) The basis of each asset received by Controlled from Distributing will equal
the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).
(5) The holding period of each asset received by Controlled will include the period during which Distributing held the asset (§ 1223(2)).
(6) Gain, if any, will be recognized by Distributing on the Distribution (§ 355(e)).
(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholders on the Distribution (§ 355(a)(1)).
(8) The aggregate basis of the Controlled and Distributing stock in the hands of each shareholder after the Distribution will equal the aggregate basis of the 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 each Distributing shareholder will include the holding period of the Distributing stock on which the Distribution is made, provided the stock is held as a capital asset on the date of the Distribution (§ 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).
(11) Assuming the Merger qualifies as a reorganization under $\S 368(a)(1)(A)$, the Merger will not adversely affect rulings (1) through (10).

## Caveats

We express no opinion about the tax treatment of the Transactions under any other section of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Transactions that are not specifically covered in the above rulings. In particular, no opinion is expressed regarding (i) treatment of the distribution described above in step (iv) or (ii) whether the Merger described above in step (vii) qualifies as a reorganization under § 368(a)(1)(A).

## Procedural Statements

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

A copy of this ruling letter should be attached to the federal income tax return of
each affected taxpayer for the taxable year in which the Transactions are completed.
In accordance with the power of attorney on file in this office, the taxpayer and a second authorized representative each will receive a copy of this letter.

Sincerely,
Assistant Chief Counsel (Corporate)

By
Wayne T. Murray
Senior Technician/Reviewer
Branch 4

