

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Refer Reply To:
CC:CORP:4 PLR-118279-00
Date:
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Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

Target =

Shareholder A =

Shareholder B =

Business C =

Investor D =

Financial Adviser =

Manufacturer =

F Sub 1 =

F Sub 2 =

F Sub 3 =

F Sub 4 =

F Sub 5 =

F Sub 6 =

F Sub 7 =

F Sub 8 =

F Sub 9 =

F Sub 10 =

F Sub 11 =

Country 1 =

Country 2 =

Country 3 =

Country 4 =

Country 5 =

Country 6 =

Country 7 =

Date A =

Date B =

c =

e =

Date F =

g =

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i =

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m =

n =

This letter responds to your September 22, 2000 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

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

Summary of Facts

Distributing is the common parent of a group of corporations whose includible affiliates join in filing a consolidated federal income tax return. Distributing owns directly all the outstanding stock of newly formed Sub 1, Sub 3, and Controlled, and all the outstanding common stock and Series A preferred stock of newly formed Sub 2. All the Sub 2 Series B preferred stock is held by Investor A. Before the transaction described below, Distributing owned directly all the outstanding stock of F Sub 1, F Sub 2, F Sub 3, F Sub 4, F Sub 5, F Sub 6, F Sub 7, and F Sub 8, with the exception of nominal shares held by third parties for the purpose of complying with local corporation laws. Sub 1, Sub 2, Sub 3, and Controlled are domestic corporations. All of the F Subs are foreign.

Distributing has one class of common stock and two classes of convertible preferred stock outstanding. The common is publicly traded and the preferred is held by Investor D. It is expected that Distributing will issue a new class of convertible preferred stock before the transaction as partial consideration for Distributing's impending acquisition of the stock of Target. Distributing also has outstanding warrants on common stock that are held by Investor D and may issue additional similar warrants to Investor D. To the best of Distributing's knowledge on Date A, Shareholder B was the only shareholder that held five percent or more of its stock by vote or value.

Until the contribution of its operating assets to Sub 1, Sub 2, Sub 3, and Controlled described in step (i) below, Distributing had conducted Business C directly. You have submitted financial information indicating that the conduct of Business C has

generated gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Controlled has both common and preferred shares outstanding, all of which are held by Distributing. Controlled also has outstanding warrants on common stock that are held by Investor D and may issue additional similar warrants to Investor D.

To obtain working capital, fund expansion, and further other business goals, Distributing and Controlled propose to raise additional capital through an initial public offering of up to 20 percent of the Controlled stock (the "Offering"). In a detailed and reasoned letter, Financial Adviser has concluded that announcing the Distribution before the Offering will result in significantly more funds per share (net of transaction costs) being raised than if no announcement were made or the offering were of Distributing stock.

Proposed Transaction

To prepare for and carry out the Offering, Distributing has proposed and partially undertaken the following transaction:

(i) On or about Date B, Distributing contributed all of its operating assets, the stock of certain subsidiaries, and certain other assets to newly formed subsidiaries Sub 1, Sub 2, Sub 3, and Controlled (the contributions to Controlled alone and the Country 6 Transfer to Controlled described below in step (vii)(d), together, the "Contribution").

(ii) Distributing will contribute substantially all of its remaining, nonoperating assets (other than the stock of Sub 1, Sub 2, Sub 3, and Controlled) to Sub 2 and Controlled, and then will contribute the stock of Sub 1 and Sub 3 to Sub 2.

(iii) The Controlled preferred stock will be converted into Controlled common stock, leaving Controlled with only common stock outstanding, all of which will be held by Distributing.

(iv) Controlled will make the Offering.

(v) After the Offering, Distributing will distribute the Controlled common stock pro rata to the holders of its common stock and to Investor D (the "Distribution").

(vi) Distributing will distribute c dollars in cash to Investor D on its convertible preferred stock (the "Cash Distribution").

(vii) The following additional transactions have occurred or are contemplated as part of the transaction:

(a) Distributing has transferred to Sub 1 all the outstanding stock of F Sub 1, F Sub 2, F Sub 3, F Sub 4, F Sub 5, and F Sub 6 (collectively, "F Sub Group 1"). Distributing will also transfer to Sub 1 all the outstanding stock of F Sub 7 and F Sub 8 (together, "F Sub Group 2").

(b) Controlled has formed F Sub 9, which has registered to do business as a branch in Country 1, Country 2, Country 3, Country 4, and Country 5. Controlled has also formed F Sub 10 and F Sub 11. Controlled will contribute to F Sub 9, F Sub 10, and F Sub 11 (collectively, "F Sub Group 3") g, h, and i dollars in cash, respectively. No other contributions to F Sub Group 3 are planned or intended.

(c) Each member of F Sub Group 1 will transfer to F Sub 9 (or one of its branches) (i) certain assets consisting of employees located outside the United States (the "US"), (ii) tangible personal property located outside the US, and (iii) certain other assets. Each transfer will be for fair market value consideration as reflected by credits and debits in the intercompany accounts. These transfers are expected to result in net gain recognition for federal income tax purposes.

(d) Each member of F Sub Group 2 will transfer employees located outside the US and tangible personal property located outside the US to F Sub 10 and F Sub 11. These transfers will be made for fair market value consideration.

(e) Distributing will transfer to Controlled its branch located in Country 6 (the "Country 6 Transfer"). This branch consists of j employees and approximately k dollars of tangible personal property. The Country 6 Transfer will be made in exchange for fair market value consideration (the "Transfer Payment").

(f) Distributing will no longer be engaged in an active trade or business in Country 6 after the Country 6 Transfer.

(g) A corporation formed under the laws of Country 7 and wholly owned by Controlled will commence business. Controlled will contribute only cash to the Country 7 corporation and has no plan or intention to contribute other than cash. Further, this corporation will not receive any assets from Sub 1, Sub 2, or Sub 3 or any of their subsidiaries. It is expected that the Country 7 corporation will be a controlled foreign corporation under § 957 of the Internal Revenue Code and will not be a passive foreign investment company under § 1297.

(h) Before the Distribution, Distributing will either sell to an unrelated party or contribute to Sub 1, Sub 2, or Sub 3 all foreign stock currently held by Distributing.

Following the Distribution, (i) Distributing will supply Controlled with certain administrative services under a services agreement for a transitional period of not more than three years, (ii) Controlled may purchase or sell products or services to Sub 1, Sub

2, or Sub 3 for use in business or for resale pursuant to supply agreements for a similar transitional period, and (iii) Controlled will have an agreed right to purchase products directly from unrelated Manufacturer (which has a short-term manufacturing services contract with Sub 1), or from Sub 1, for resale at prices determined by the agreement between Sub 1 and Manufacturer (collectively, the “Transitional Agreements”).

Distributing and Controlled have issued and may continue to issue stock options as compensation to officers, employees, and directors (the “Controlled Compensatory Options”). Controlled has also issued other options. In connection with the Distribution, Controlled will issue Controlled options to holders of Distributing options as compensation for the decrease in Distributing option value caused by the Distribution. Controlled also will issue to Investor D additional Controlled warrants (i) for a number of Controlled common shares equal to the number of shares Investor D would have received in the Distribution if Investor D had exercised its Distributing warrants immediately before the Distribution and (ii) for n common shares if the value of Controlled equity (assuming all outstanding options are exercised) immediately after the Offering exceeds e dollars.

On Date F, Distributing announced its plan to proceed with an initial public offering of Sub 3 stock, to be followed by a distribution of Distributing’s Sub 3 stock to its shareholders (the “Sub 3 IPO and Sub 3 Distribution”).

Representations

Distributing has made the following representations regarding the proposed transaction:

(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 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, Sub 1, Sub 2, Sub 3, and Controlled (the “Distributing Group”) for Business C represents the Distributing Group’s present operation, and with regard to the Distributing Group, there have been no substantial operational changes since the date of the last financial statements submitted.

(d) Immediately after the Distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock and securities of Sub 2, which will be engaged in the active conduct of a trade or business as defined in § 355(b)(2).

(e) The gross assets of the business relied upon by Controlled to satisfy the active trade or business test of § 355(b) will have a fair market value equal to or greater than five percent of the total fair market value of the gross assets of Controlled immediately after the Distribution.

(e1) The gross assets of the business relied upon by Sub 2 to satisfy the active trade or business test of § 355(b) will have a fair market value equal to or greater than five percent of the total fair market value of the gross assets of such Sub 2 immediately after the Distribution.

(f) Following the Distribution, Controlled and Distributing (through Sub 2) each will continue, independently and with its separate employees, the active conduct of its share of the integrated activities of Business C.

(g) Distributing has no plan or intention to sell, exchange, transfer, or otherwise dispose of any Sub 2 stock.

(h) The Distribution is carried out to facilitate the Offering. The Distribution is motivated, in whole or substantial part, by this and other corporate business purposes.

(i) The Distribution will occur no later than the later of twelve months after the Offering or three months after this letter ruling is issued.

(j) There is no plan or intention by Shareholder B, 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 of Distributing, to sell, exchange, transfer by gift, or otherwise dispose of any stock in, or securities of, either Distributing or Controlled after the transaction.

(k) 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, 1996-1 C.B. 696, 705.

(l) 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 that Sub 2 may sell or otherwise dispose of Sub 1 or Sub 3 or both (including through distributions to Distributing's shareholders). Distributing further represents that Sub 2's continued conduct of a significant active trade or business under § 355(b) would be unaffected by any disposition of Sub 1 or Sub 3 or both. See representations (d), (e1), and (f).

(m) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing in the Contribution will, in each instance, each equal or exceed the sum of the liabilities assumed (as determined under § 357(d)) by Controlled.

(n) The liabilities assumed in the transaction (as determined under § 357(d)) 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 § 47(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) Except for intercompany payables and receivables between members of the Distributing Group incurred in the ordinary course of business, no intercorporate debt will exist between Distributing or any of its subsidiaries and Controlled or any of its subsidiaries at the time of, or after, the Distribution.

(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 under applicable regulations (see § 1.1502-19).

(r) Except for those made under the Transitional Agreements, payments made in connection with all continuing transactions between Controlled or any of its subsidiaries and Distributing or any of its subsidiaries will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(s) Neither Distributing nor Controlled is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).

(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 percent or more of the total combined voting power of all classes of stock of Distributing or Controlled entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.

(u) The Controlled Compensatory Options (i) contain or will contain customary

terms and conditions, (ii) were or will be granted in connection with the performance of services for Distributing or Controlled or a person related to the grantor under § 355(d)(7)(A), (iii) were not or will not be excessive by reference to the services performed, (iv) will not be transferable within the meaning of § 1.83-3(d) immediately after the Distribution or within six months thereafter, and (v) will not have a readily ascertainable fair market value as defined in § 1.83-7(b) immediately after the Distribution or within six months thereafter.

(v) Each member of F Sub Group 1 is a controlled foreign corporation (“CFC”) within the meaning of § 957.

(w) No member of F Sub Group 1 is a passive foreign investment company (“PFIC”) within the meaning of § 1297.

(x) Each member of F Sub Group 1 has existed and been engaged in business for longer than l years (except for F Sub 5, which has existed and been in business for longer than m years) and is, or will be as a result of the transaction, wholly owned by Sub 1 (except for nominal shares held by third parties for the purpose of complying with local corporation laws).

(y) Each transfer of an asset from F Sub Group 1 to F Sub 9 (or one of its branches) will be for consideration equal to the fair market value of the asset being transferred, as reflected by credits and debits in the intercompany accounts of F Sub 9 and F Sub Group 1, and neither Controlled, F Sub 9, nor any other subsidiary of Controlled will assume any liability of F Sub Group 1 in connection with the transfer.

(z) Each asset being transferred by a member of F Sub Group 1 to F Sub 9 (i) has been used in an active trade or business by F Sub Group 1, (ii) represents a small portion of its assets, and (iii) will continue to be used in an active trade or business by F Sub 9 after the transfer. Each member of F Sub Group 1 will continue to be engaged in an active trade or business after the transfers.

(aa) No asset transferred by a member of F Sub Group 1 was acquired by the member in connection with the transaction and in each case was acquired by the member for fair market value from an unrelated party in the ordinary course of its business.

(bb) Each member of F Sub Group 2 is a CFC within the meaning of § 957.

(cc) No member of F Sub Group 2 is a PFIC within the meaning of § 1297.

(dd) Each member of F Sub Group 2 has existed and been engaged in business for longer than l years and, after being contributed to Sub 1, will be wholly owned by Sub 1 (except for nominal shares held by third parties for purposes of complying with

local corporation laws).

(ee) Each transfer of an asset from F Sub Group 2 to F Sub 10 and F Sub 11 will be for consideration equal to the fair market value of the asset being transferred, as reflected by credits and debits in the intercompany accounts of F Sub 10, F Sub 11, and F Sub Group 2, and neither Controlled, F Sub 10, F Sub 11 nor any other subsidiary of Controlled will assume any liability of Sub 1 or F Sub Group 2 in connection with the transfer.

(ff) No asset transferred by a member of F Sub Group 2 was acquired by the member in connection with the transaction and in each case was acquired by the member for fair market value from an unrelated party in the ordinary course of its business.

(gg) Each asset being transferred by a member of F Sub Group 2 (i) has been used in an active trade or business by F Sub Group 2, (ii) represents a small portion of its assets, and (iii) will continue to be used in an active trade or business by F Sub 10 or F Sub 11 after the transfer. Each member of F Sub Group 2 will continue to be engaged in an active trade or business after the transfers.

(hh) Each member of F Sub Group 3 is a CFC within the meaning of § 957.

(ii) No member of F Sub Group 3 is a PFIC within the meaning of § 1297.

(jj) The Country 6 Transfer will be for consideration equal to the fair market value of the assets being transferred, as reflected by credits and debits in the intercompany accounts of Controlled and Distributing.

(kk) Distributing will not have been a United States real property holding corporation (as defined in § 897(c)(2)) at any time during the five-year period ending on the date of the Distribution.

Rulings

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

(1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be “a party to a reorganization” under § 368(b).

(2) Distributing will recognize gain as a result of its receipt of Controlled stock and the Transfer Payment in the Contribution to the extent of the Transfer Payment, unless the Transfer Payment is transferred by Distributing to its creditors in connection

with the proposed transaction (§ 361(a), (b)(1)(B), and (b)(3); § 357(a)). This gain will be taken into account as required by applicable intercompany regulations (see § 1.1502-13). No loss will be recognized by Distributing in the Contribution (§ 361(b)(2)).

(3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).

(4) The basis of each asset received by Controlled in the Contribution 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 in the Contribution will include the period during which Distributing held that asset before the Contribution (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)).

(7) Except for the Cash Distribution, no gain or loss will be recognized by (and no amount will otherwise be included in the income of) Distributing's shareholders on the Distribution (§§ 355(a)(1) and 356). The Cash Distribution will be treated as a distribution of property to which § 301 applies (§ 356(b); § 1.356-2(a)).

(8) The aggregate basis of the Distributing stock and the stock of Controlled in the hands of each Distributing shareholder after the Distribution will equal the basis of the Distributing stock held by the shareholder immediately before the Distribution, decreased by the amount of cash received by such shareholder in the Distribution and increased by the amount of such cash treated as a dividend to such shareholder (§§ 358(a)(1) and 358(c)). The aggregate basis will be allocated between the Distributing stock and Controlled stock in proportion to the fair market value of each immediately after the Distribution in accordance with § 1.358-2(a)(2) (§ 358(b)(2)).

(9) The holding period of the Controlled stock received by each Distributing shareholder in the Distribution will include the holding period of the Distributing stock on which the Distribution is made, provided the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(10) Earnings and profits will be allocated between Distributing and Controlled in accordance with §§ 312(h), 1.312-10(a), and 1.1502-33(e)(3).

(11) The issuance or exercise of a Controlled Compensatory Option is not an acquisition pursuant to a plan for purposes of § 355(e)(2)(A)(ii).

Caveats

We express no opinion 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 transaction that are not specifically covered by the above rulings. In particular, we express no opinion about:

- (i) The Cash Distribution described above in step (vi);
- (ii) Any non-arm's-length payments under the Transitional Agreements;
- (iii) The effect of the issuance or exercise of stock options other than the Controlled Compensatory Options under § 355(e) or any other provision of the Code;
- (iv) The deductibility and taxability of stock issued on the exercise of any stock option;
- (v) The Sub 3 IPO and Sub 3 Distribution; and
- (vi) Whether any or all of the above-described foreign corporations are PFICs within the meaning of § 1297(a) and any related regulations. If it is determined that any of the above-described foreign corporations is a PFIC, no opinion is expressed regarding the application of §§ 1291 through 1298 to the proposed transaction. In particular, in a transaction in which gain is not recognized, regulations under § 1291(f) may require gain recognition notwithstanding any other provision of the Code.

No opinion has been requested and none is provided about the federal income tax consequences of the various foreign restructuring transactions involving Distributing's subsidiaries. In particular, no opinion is expressed about the application of § 304, § 367(a), § 367(b), or § 1248 to any foreign restructuring transaction.

Temporary or final regulations pertaining to one or more issues addressed in this ruling letter (including regulations under § 355(e)) have yet to be adopted. Therefore, this ruling letter may be revoked or modified if adopted temporary or final regulations are inconsistent with any conclusions reached herein. See § 12.04 of Rev. Proc. 2001-1, 2001-1 I.R.B. 1, 46, which addresses in greater detail when a ruling will be revoked or modified. However, when the criteria in § 12.05 of Rev. Proc. 2001-1 are satisfied, a ruling is seldom revoked or modified retroactively, except in rare or unusual circumstances.

Procedural Information

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.

It is important that a copy of this ruling letter be attached to the federal income tax return of each party involved for the taxable year in which the transaction covered by this letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to each of your authorized representatives.

Sincerely yours,
Associate Chief Counsel (Corporate)
By: Wayne T. Murray
Senior Technician/Reviewer
Branch 4