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Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP:1-PLR-121117-98
Date:
August 3, 1999

Re:

Parent =

Distributing =

Controlled =

Business A =

Business B =

Business C =

Corporation D =

Product A =

Individual E =

Corporation F =

aa =

bb =

cc =

dd =

ee =

ff =

gg =

hh =

ii =

jj =

kk =

mm =

nn =

oo =

pp =

qq =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

x =

y =

z =

Dear :

This letter responds to your request dated November 16, 1998, for rulings concerning the federal income tax consequences of a proposed transaction (the "Proposed Transaction"). Additional information was provided in submissions dated January 29, 1999, April 14, 1999, June 10, 1999, June 21, 1999, July 8, 1999, July 13,

1999, July 15, 1999, and July 26, 1999. The facts submitted are summarized below.

Parent is a publicly traded company and the common parent of an affiliated group of corporations that file a consolidated return for federal income tax purposes. Parent owns all of the stock of Distributing, which represents substantially all of Parent's assets. Distributing owns all the stock of Controlled and numerous other direct and indirect subsidiaries. Distributing is directly engaged in Business A and indirectly operates a variety of other businesses, including Business C. Controlled is directly engaged in Business B.

Parent has two classes of common stock outstanding, Parent Class A voting common stock and Parent Class B nonvoting common stock. Except for voting rights, the two classes are identical. Both classes of stock are publicly traded. As of Date 1, there were approximately aa shares of Parent Class A stock outstanding and approximately bb shares of Parent Class B stock outstanding. As of Date 1, approximately cc shares of Parent Class A stock, representing dd percent of the outstanding Parent Class A stock, and ee shares of Parent Class B stock, representing ff percent of the outstanding Parent Class B stock, were owned by Corporation D. As of Date 1, approximately gg shares of Parent Class A stock and hh shares of Parent Class B stock are owned by Individual E, who is the Chief Executive Officer and Chairman of the Board of Directors of Parent. Individual E and members of his family, directly and indirectly, also own all of the stock of Corporation D. There are also four institutional shareholders that through various funds and entities own more than 5 percent of the Parent Class A and Parent Class B stock. To the best knowledge of Parent, the remainder of the Parent Class A and Parent Class B stock is held by less than 5 percent shareholders.

Parent acquired ownership of Controlled on Date 2 (more than five years prior to the date of the Proposed Transaction) in a transaction in which Corporation F, the former parent of the consolidated group of which Controlled was a member, was merged with and into Parent (the "Z Merger"). Subsequently, as part of a separate transaction, several other subsidiaries that were also acquired by Parent in the Z Merger and that were engaged in Business B were merged with and into Controlled. In addition, Controlled acquired the stock and/or assets of certain other Parent subsidiaries that are engaged in Business B outside of the United States.

On Date 3, Controlled declared a dividend to Distributing in the form of a $ii promissory note (the "Dividend Note"). On Date 4, Controlled entered into term and revolving credit agreements with unrelated third-party lenders in the aggregate of $ jj; $kk was drawn down on Date 5. Such proceeds were used to pay (i) a portion of the purchase price for the acquisition of the non-U.S. Business B operations, (ii) the Dividend Note and other notes owed to Distributing, and (iii) certain fees and expenses

incurred in connection with the draw down of funds.

Controlled derives the majority of its income from the rental of Product A. It recently developed a new business practice whereby it enters arrangements to procure Product A from its suppliers at a greatly reduced initial price in return for a portion of the revenue derived from the rental of Product A over a specific period of time ("the Revenue Sharing Arrangements"). These new arrangements have resulted in greatly increasing Controlled's revenues and profitability. However, this arrangement necessitates a closer working relationship between Controlled and its suppliers, and requires its suppliers to share confidential information with Controlled. Its suppliers have indicated that their relationship with Controlled is strained by Controlled's affiliation with Distributing, because one of the major businesses of Distributing is in direct competition with Controlled's suppliers. Parent fears that Controlled's affiliation with a competitor of the suppliers may cause the suppliers to take action with respect to the revenue sharing arrangements, which would materially adversely affect Controlled's revenues and profitability.

In order to address these issues, management of Distributing and Controlled has determined that Distributing and Controlled should be separated. Accordingly, they propose the following Proposed Transaction:

A. Parent and Controlled will enter into several Transaction Agreements (the "Transaction Agreements"). The Transactions Agreements will provide for sharing of certain resources until the remainder of the transaction is consummated. The Transaction Agreements will also allocate tax and other contingent liabilities of the Parent consolidated group between Controlled and other members of the Parent consolidated group.

B. Controlled will recapitalize, providing for two classes of common stock: a Class A with x votes per share and a Class B with y votes per share. This new Class B common stock will have the following characteristics:

(i) Each share may be converted into a share of Class A stock at the holder's option prior to the Split-off Transaction described in STEP D and STEP E;

(ii) If z percent or less by value of Controlled's aggregate outstanding stock is issued prior to the Split-off Transaction, each share of Class B stock will automatically convert, pursuant to its terms, into a share of Class A stock.

(iii) Unless approved by the majority of the holders of the Class A stock and the majority of the holders of the Class B stock, in the event of Controlled's reorganization or consolidation with one or more corporations

in which Class A Controlled stock and Class B Controlled stock is converted into or exchanged for shares of stock, other securities or property (including cash), all holders of Controlled stock, regardless of class, will be entitled to receive the same kind and number of shares of stock and other securities and property, except that the relative voting rights of the Class A stock and the Class B stock may be retained.

C. In an initial public offering shortly after the recapitalization, Controlled will issue Class A stock representing no more than twenty percent by vote of Controlled's aggregate outstanding stock, but between mm and nn percent by value. Prior to the First Distribution, Controlled may also issue Class A Controlled stock in connection with acquisitions and/or pursuant to a second public offering. In any event, Distributing will continue to own at least eighty percent by vote and oo percent by value of Controlled's aggregate outstanding stock until the First Distribution. The shares issued in a second offering or in connection with acquisitions may represent sufficient value to disaffiliate Controlled from the Parent Group under § 1504; however, Distributing will continue to own stock possessing at least eighty percent of Controlled's voting power. Additionally, Controlled will issue compensatory employee stock options for its Class A stock ("Controlled Stock Options") that will satisfy the safe harbor for compensatory options under § 1.1504-4(d)(2)(v).

D. After Date 6, Distributing will distribute all of its Controlled stock to Parent (the "First Distribution").

E. Immediately after the First Distribution, Parent will make a distribution of all of the Controlled stock received by Parent pursuant to the First Distribution to certain Parent shareholders (the "Second Distribution," together with the First Distribution, the "Split-off Transaction"). The Second Distribution will be accomplished through the mechanism of an exchange offer, a "dutch auction" in which Parent offers its shareholders the opportunity to tender their Parent shares and receive shares of Controlled in exchange. Neither Corporation D nor Individual E will participate in the exchange offer. If the amount of Parent stock tendered by Parent shareholders in the exchange offer is not sufficient to result in a distribution of 100 percent of Parent's Controlled stock, Parent will distribute as soon as practicable all remaining shares pro rata to its shareholders of record at the close of business on a record date promptly after consummation of the exchange offer (a "Backup Distribution"). The terms of the exchange offer will be structured in such a way as to ensure that, if a Backup Distribution is necessary, Corporation D and Individual E together will receive no more than pp percent of the total number of shares of Controlled stock. If Corporation D and Individual E should receive more than pp percent of the Controlled stock in the Backup Distribution, the Split-off transaction will not occur and Controlled will remain a subsidiary of Distributing.

F. After the Split-off transaction, Controlled and Parent may share up to qq employees until no later than Date 7 (the "Shared Employees"). The Shared Employees will remain employees of Controlled and will also work for a newly-created special purpose subsidiary of Distributing to assist in transition services after the Proposed Transaction, including implementation of Controlled and Parent's obligations under the Transaction Agreements.

The taxpayer has made the following representations in connection with the Proposed Transaction:

(a) No part of the consideration to be distributed by either Parent or Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder.

(b) The five years of financial information submitted on behalf of Distributing and Controlled is representative of each respective corporations' present operation, and with regard to each such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(c) Immediately after the Split-off Transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of their respective businesses, except for the Shared Employees described above.

(d) Immediately after the Split-off Transaction, at least 90 percent of the fair market value of the gross assets of Parent will consist of the stock of Distributing, which is engaged in the active conduct of a trade or business as defined in § 355(b)(2).

(e) The transaction is being carried out to resolve Controlled's problems with suppliers who object to Controlled 's being associated with Distributing, which is engaged in Business C, a business that directly competes with such suppliers. The Split-off Transaction is motivated, in whole or substantial part, by this corporate business purpose.

(f) Except for the disposition of Controlled stock by Distributing in the Split-off Transaction, there is no plan or intention by Parent to sell, exchange, transfer by gift, or otherwise dispose of Distributing or Controlled stock after the First Distribution.

(g) There is no plan or intention by any shareholder who owns 5 percent or

more of the stock of Parent, and the management of Parent, to its best knowledge, is not aware of any plan or intention on the part of any particular remaining shareholder or security holder of Parent, to sell, exchange, transfer by gift, or otherwise dispose of either Parent or Controlled stock after the Split-off Transaction.

(h) There is no plan or intention by Parent, Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the Split-off Transaction, other than through stock purchases meeting the requirements of Section 4.05(1)(b) of Rev. Proc. 96-30.

(i) There is no plan or intention to liquidate Parent, Distributing or Controlled, to merge them with any other corporation, or to sell or otherwise dispose of their assets after the Split-off Transaction, except in the ordinary course of business.

(j) Except for contingent liabilities arising from the intercompany agreements governing the separation of Controlled from the Parent group and except for agreements entered into in the ordinary course of business, no intercorporate debt will exist between Parent, Distributing, and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.

(k) Immediately before Controlled is disaffiliated from the Parent Group under § 1504, items of income, gain, loss, deduction and credit will be taken into account as required by the applicable intercompany transaction regulations. Neither Parent nor Distributing will have an excess loss account with respect to Controlled stock.

(l) Payments made in connection with all continuing transactions among Parent, Distributing and Controlled will be for approximate fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(m) For purposes of § 355(d), immediately after the First and Second Distributions, no person will hold disqualified stock (under § 355(d)(3)) in Parent or Controlled possessing 50 percent or more of the total combined voting power of all classes of Parent or Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of Parent or Controlled stock.

(n) The First and Second Distributions are not (within the meaning of § 355(e)) part of a plan or series of related transactions 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 either Parent or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Parent or Controlled.

(o) None of Distributing, Parent, or Controlled is (or will be) a foreign corporation.

(p) To the best knowledge of Distributing, no foreign shareholder is expected to own 5 percent or more of any class of Distributing or Controlled stock after the Second Distribution.

(q) Neither Distributing nor Controlled have been (nor will they be) a United States real property holding corporation (as defined in § 897(c)(2)) at any time during the 5-year period ending on the date of the First Distribution or the Second Distribution, and neither of them will be a United States real property holding corporation immediately after the First Distribution or the Second Distribution.

Based solely on the information submitted and the representations set forth above, we rule as follows with respect to the First Distribution:

(1) No gain or loss will be recognized by Distributing on the distribution of the Controlled stock to Parent (§355(c)(1)).

(2) No gain or loss will be recognized by (and no amount will be included in the income of) Parent on the receipt of the Controlled stock (§ 355(a)(1)).

(3) The aggregate basis of the Controlled stock and the Distributing stock in the hands of Parent, immediately following the First Distribution, will be the same as the basis of the Distributing stock held by Parent immediately before the First Distribution, allocated in proportion to the relative fair market values of each at the time of the First Distribution in accordance with § 1.358-2(a)(2) (§§ 358(a)(1), (b)(1), and (b)(2)).

(4) The holding period of the Controlled stock received by Parent will include the holding period of the Distributing stock with respect to which the distribution will be made, provided that the Distributing stock is held as a capital asset on the date of the distribution (§ 1223).

(5) 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.

Based solely on the information submitted and the representations set forth above, we rule as follows with respect to the Second Distribution:

(6) No gain or loss will be recognized by Parent on the distribution of the Controlled stock to the Parent shareholders (§ 355(c)(1)).

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

(8) The aggregate basis of the Controlled stock and the Parent stock in the hands of the shareholders of Parent, immediately following the Second Distribution, will be the same as the basis of the Parent stock held by Parent shareholders immediately before the Second Distribution, allocated in proportion to the relative fair market values of each at the time of the Second Distribution in accordance with § 1.358-2(a)(2) (§§ 358(a)(1), (b)(1), and (b)(2)).

(9) The holding period of the Controlled stock received by Parent shareholders will include the holding period of the Parent stock with respect to which the distribution will be made, provided that the Parent 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 Parent and Controlled will be made under §§ 1.312-10(a) and 1.1502-33.

(11) Pursuant to the Temporary Regulations under § 367(e)(1) that are currently in effect, if Distributing does not distribute Controlled stock to its shareholders having a value of more than 80 percent of the total value of the total outstanding Class A and Class B common stock in connection with the Second Distribution, Distributing will recognize gain in connection with the Second Distribution pursuant to § 367(e)(1) to the extent that the distributees of the Controlled stock are not qualified U.S. persons within the meaning of Temporary Regulation § 1.367(e)-1T(b)(1)(i).

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter have not yet been adopted. Therefore, this ruling letter may be revoked or modified upon the issuance of temporary or final regulations (or a notice with respect to their future issuance). See section 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, which discusses in greater detail the revocation or modification of ruling letters.

However, when the criteria in section 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances. 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.

No opinion is expressed about the tax treatment of the proposed transaction under any other provisions of the Code and regulations or 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.

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.

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

A copy of this letter is being sent to your authorized representative.

Sincerely,

Assistant Chief Counsel (Corporate)

By: _____

Mark S. Jennings
Senior Technician Reviewer
Branch 1