

INTERNAL REVENUE SERVICE

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May 17, 2001

LEGEND:

Distributing =
Controlled =
Company X =
a =
Date 5 =
Date 6 =
Date 7 =
Date 10 =
Month M =
Distributing =
Senior Officer

This letter responds to a letter dated April 12, 2001, requesting a ruling supplementing our prior letter ruling dated March 14, 2001 (PLR-111625-01) issued to your company and to Controlled (the "Prior Letter Ruling"). The Prior Letter Ruling, which is incorporated herein by reference, addresses a distribution (Step V) of Controlled stock by Distributing under § 355 of the Internal Revenue Code (the "Spin Off") and various pre-Spin Off steps (including the Step IV issuance by Controlled of a portion of its stock to the public (the "IPO")). The IPO took place on Date 10.

The Spin Off was announced to the public (the "Announcement") on Date 5. The Spin Off was intended to occur between Date 6 and Date 7, which are after the date of this letter. At the time of the Announcement, Distributing had enjoyed many years of strong revenue growth, and projected continuing revenue growth for the coming year.

Subsequent to Date 5, Distributing suffered dramatic economic reversals due to a number of factors, including a severe contraction of Distributing's industry. During this period of decline, Distributing's market capitalization dropped a% (which is more than 85%), and Distributing posted record operating losses.

In response to these changed financial circumstances, Distributing recently shifted its historic business strategy of operating as an independent company and entered into negotiations with Company X for the combination of their businesses. As of the date of this letter, it is anticipated that Company X (or a related entity) will acquire the stock of Distributing (the "Proposed Combination") in a transaction that is intended to be tax-free. The Proposed Combination will most likely constitute an acquisition of a "50-percent or greater interest" (within the meaning of § 355(e)(2)(A)(ii)) in Distributing. It is also likely that the Proposed Combination will occur either within 6 months before or within 6 months after the Spin Off.

The taxpayer has represented that no discussions or contacts with Company X took place before the Announcement or at any time after the Announcement prior to Month M, and that the Spin Off is still intended to occur between Date 6 and Date 7. The information submitted also suggests that, at the time of the Announcement, Distributing's size and position in its industry made the possibility of any acquisition of Distributing very remote.

The taxpayer has also represented that the business purposes for the Spin Off that existed on Date 5 remain equally important to Distributing and Controlled at this time, and that the Spin Off is intended to occur at approximately the same time and in similar form regardless of whether the Proposed Combination takes place. Distributing has submitted substantial, extensively detailed information and documentation in support of these representations, including affidavits from several senior executives of Distributing and Controlled.

One of the affidavits, executed by Distributing Senior Officer, indicates that, during discussions with Company X regarding the Proposed Combination, Company X expressed interest in having Distributing retain Controlled. According to the affidavit, Distributing told Company X on several occasions that the Spin Off needed to proceed on schedule for reasons relating to strategic conflicts and employee retention, regardless of the Proposed Combination.

In connection with this supplemental ruling request, Distributing represents that, as of the date of the Prior Letter Ruling, representations (o), (p), (s), and (v) in that letter were true as stated therein. Presently, Distributing modifies

representations (o), (p), (s) and (v) of the Prior Letter Ruling as follows:

(Add the following sentence at the end of prior representation (o).) These business purposes existed at the time of the Announcement, are equally important to Distributing and Controlled at the present time, and are unaffected by the business purposes for the Proposed Combination.

(Add the following sentence at the end of prior representation (p).) The term "Acquisition," as used in this representation, includes the Proposed Combination.

(Add the following clause at the end of the first sentence of prior representation (s).) "and except for the Proposed Combination."

(Add the following clause at the end of the last sentence of prior representation (v).) "and except for the Proposed Combination."

Distributing also represents that all of the other representations in the Prior Letter Ruling continue to be true at the present time. Finally, Distributing makes the following additional representation:

(ee) There were no discussions or contacts between Distributing and Company X before the Announcement or at any time after the Announcement prior to Month M (apart from any possible routine business contacts unrelated to any acquisition of Distributing).

ANALYSIS

In the present situation, the fact that Company X intends to acquire a 50-percent or greater interest in Distributing raises the question of whether the Spin Off and the Proposed Combination are part of the same plan for purposes of § 355(e) (a "Plan"). Some of the facts in this case suggest that the Spin Off and Proposed Combination are part of a Plan, while other facts indicate that the Spin Off and Proposed Combination are not part of a Plan.

Facts indicating that the two transactions are part of a Plan include the following:

- (A) Proximity in time. The Spin Off and the Proposed Combination are anticipated to occur within 6 months of each other.
- (B) Intent to undertake the second transaction at the time the first transaction is consummated. Regardless of whether the

Spin Off occurs before or after the Proposed Combination, it will be intended at the time of the first transaction that the second transaction take place.

- (C) Acquisition was pursued in the period between the public announcement and the distribution. Distributing and Company X began discussing the Proposed Combination, and decided to pursue the Proposed Combination, after the Announcement and before the Spin Off.

Facts indicating that the Spin Off and the Proposed Combination are not part of a Plan include the following:

- (1) Severe and unexpected changes in Distributing's financial condition. Distributing's extreme financial reversals subsequent to the Announcement, which motivated Distributing to consider the Proposed Combination, could not have been expected at the time of the Announcement. Furthermore, the information submitted indicates that at the time of the Announcement the possibility that any acquisition of Distributing could occur was remote.
- (2) Absence of discussions regarding the acquisition before the public announcement and until after unexpected events. There were no discussions between Distributing and Controlled before the Announcement, and discussions did not begin until after the unexpected financial reversals described above.
- (3) Corporate business purposes for the distribution unrelated to the acquisition. Although facts (A), (B), and (C) above might suggest that one of the reasons for the Spin Off was to facilitate the Proposed Combination or a similar transaction, the substantial documentation submitted regarding the continuing, independent importance to Distributing and Controlled of the above-stated business purposes for the Spin Off indicates that such business purposes are unrelated to the purposes motivating the Proposed Combination.
- (4) Distribution will occur regardless of the acquisition. Facts (1), (2), and (3) above, as well as other information submitted, including the fact that Distributing decided to proceed with the Spin Off notwithstanding Company X's expressed desire to have Distributing retain Controlled, indicate that the Spin Off would have occurred at around the same time and in similar form regardless of the Proposed Combination.

We conclude that Facts (1), (2), (3), and (4) outweigh Facts (A), (B), and (C) in this case.

Accordingly, based solely on the information submitted and the representations set forth above, we rule as follows:

- (15) The Proposed Combination will not be taken into account for purposes of § 355(e).

In addition to the caveats in the Prior Letter Ruling, we express no opinion about the tax treatment of the Proposed Combination, or the effects of the Proposed Combination on any of the rulings in the Prior Letter Ruling, except as specifically provided above.

The rulings in this letter are based on facts and representations submitted under penalties of perjury in support of the request for rulings. Verification of this information may be required as part of the audit process.

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

It is important that a copy of this letter, together with a copy of the Prior Ruling Letter, be attached to the federal income tax returns of the taxpayers involved for the taxable years in which the transactions covered by these letters are consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely,
Associate Chief Counsel (Corporate)
By Michael J. Wilder
Senior Technician Reviewer,
Branch 1