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Department of the Treasury

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Person to Contact:

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Date:

April 27, 2000

Re:

Target =

Acquiring =

Target ESOP =

Corp Y =

Corp C =

Corp S =

Exchange =

Corp X =

State A =

Business A =

State B =

Business B =

a =

b =

c =

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Date D =

e =

f =

g =

h =

i =

j =

Date K =

L =

Business M =

n =

o =

p =

Date Q =

Date R =

Date S =

t =

u =

v =

w =

x =

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Dear _____ :

This letter responds to your request dated December 22, 1999, for rulings on the federal income tax consequences of a proposed transaction. You submitted additional information in letters dated April 12 and April 20, 2000. The information submitted for consideration is summarized below.

Target is a State A corporation, and the common parent of a consolidated group. Target engages in Business A indirectly through its wholly owned subsidiary, Corp C, a State B corporation. Target engages in Business B indirectly through its wholly owned subsidiary, Corp S, also a State B corporation. Target's only authorized and outstanding class of stock is common stock. Approximately a percent of Target stock is owned by Target ESOP with the balance of shares held by approximately b individual shareholders. Target employees have employee stock options to acquire approximately c shares of Target common stock. Additionally, Corp Y, an unrelated party, was issued a warrant on Date D to purchase approximately e percent, or f shares, of Target common stock. The warrant was received by Corp Y in connection with a lending transaction with Corp C. In addition, an affiliate of Corp Y owns g shares of Target common stock.

Acquiring is a publicly held State A corporation. Acquiring has approximately h shares of common stock issued and outstanding. Acquiring has only one class of stock. Approximately i shares of Acquiring common stock are held by Target. The Acquiring stock held by Target represents more than 90 percent of the Target group's total net value. Approximately j shares of Acquiring common stock were sold to the public in an initial public offering (IPO) on Date K. Approximately L shares of Acquiring common stock are held by Acquiring employees who acquired their shares through the exercise of stock options. Acquiring is actively engaged in Business M. Acquiring common stock is publicly traded on Exchange.

Corp X, an unrelated public company, is the holder of n shares of Acquiring common stock and has a warrant to purchase an additional o shares at an exercise price of p dollars. Corp X acquired this warrant in connection with Acquiring's acquisition of technology from Corp X on Date Q.

Prior to the IPO of Acquiring Common Stock, Target, Acquiring, Corp C and Corp S filed a consolidated federal income tax return with a tax year end of Date R. As a result of the IPO, Acquiring is no longer a member of the affiliated group as of the date of the stock offering. Acquiring now has a tax year end of Date S.

For what have been represented to be valid business purposes, the following transactions have been proposed:

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- (i) Target will contribute approximately t million dollars of available net cash (after allowance for any unpaid Target tax liabilities and expenses) and all of the stock of Corp S to the capital of Corp C. The cash will be used by Corp C in its normal business operations.
- (ii) Target will distribute all of the Corp C stock to Target ESOP in redemption of approximately u shares of Target stock in what Target has characterized as a taxable transaction under § 311(b) of the Code.
- (iii) The warrant issued to Corp Y to acquire approximately f shares of common stock of Target will be exercised. In addition, Target employees will exercise existing employee stock options to acquire approximately c shares of common stock of Target.
- (iv) Target will transfer its remaining assets, consisting of i shares of Acquiring common stock, to Acquiring in exchange for i shares of new Acquiring common stock to be issued under the Plan of Reorganization (the "Transfer"). Target will not transfer any liabilities to Acquiring.
- (v) Target will distribute, in complete liquidation, the Acquiring common stock to Target stockholders in proportion to their respective ownership of Target stock. No other property will be distributed to Target stockholders.

Within the six-month period following the consummation of the reorganization, it is contemplated that Target stockholders other than Target ESOP will sell not less than v million and not more than w million shares of Acquiring common stock distributed to them pursuant to the reorganization. Such sales may occur in a registered secondary public offering, in market transactions or in private "block" transactions. Target stockholders will receive the shares of Acquiring common stock distributed to them in the liquidation of Target subject to agreed upon contractual lock-up arrangements designed to restrict the flow of shares into the market so as to not exceed the maximum amount set forth above, or (as a condition to the reorganization) enter into direct contractual lock-up agreements to effect the same purpose. Moreover, Target ESOP will divest itself of its Acquiring common stock as soon as prudently possible and consistent with its (i) fiduciary duties to ESOP participants and their beneficiaries, and (ii) the contractual lock-ups as discussed above.

The taxpayers have made the following representations with respect to the proposed transactions:

- (a) The fair market value of the Acquiring stock received by each Target shareholder will be approximately equal to the fair market value of the Target stock surrendered in the exchange.

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- (b) There is no plan or intention for Acquiring or any person related (as defined in § 1.368-1(e)(3) of the Income Tax Regulations) to Acquiring, to acquire or redeem, during the five-year period beginning on the date of the proposed transaction, any of the Acquiring common stock issued in the transaction either directly or indirectly or through any transaction, agreement, or arrangement with any other person.
- (c) During the five-year period ending on the date of the proposed transaction: (i) neither Acquiring, nor any person related (as defined in § 1.368-1(e)(3)) to Acquiring, will have acquired Target stock with consideration other than Acquiring stock; (ii) neither Target, nor any person related (as defined in § 1.368-1(e) determined without regard to § 1.368-1(e)(3)(i)(A)) to Target, will have acquired Target stock with consideration other than Acquiring stock or Target stock; and (iii) no distributions will have been made with respect to Target stock, other than ordinary, normal, regular, dividend distributions made pursuant to Target's historic dividend paying practice, either directly or through any transaction, agreement, or arrangement with any other person, except amounts paid to Target stockholders for redemption of x shares of Target stock as reflected in Exhibit F of the request for private letter ruling and except for the distribution of all of the Corp C stock to Target ESOP in redemption of approximately u shares of Target stock as described in step (ii), above.
- (d) The aggregate value of any acquisitions, redemptions and distributions described in (c)(i), (ii), and (iii), above, will not exceed 50 percent of the value (without giving effect to the acquisitions, redemptions, and distributions) of the proprietary interest in Target on the effective date of the proposed transaction.
- (e) Acquiring will acquire at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Target immediately prior to the transaction. For purposes of this representation, amounts used by Target to pay its reorganization expenses, amounts paid by Target to stockholders who receive cash or other property, and all redemptions and distributions (except for regular, normal dividends) made by Target immediately preceding the Transfer will be included as assets of Target held immediately prior to the transaction.
- (f) Acquiring has no plan or intention to sell or otherwise dispose of any of the assets of Target acquired in the transaction.

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- (g) Target will distribute the stock of Acquiring it receives in the transaction, and its other retained properties, in pursuance of the Plan of Reorganization.
- (h) Acquiring will not assume any Target liabilities in the transaction.
- (i) Acquiring, Target, and the stockholders of Target will pay their respective expenses, if any, incurred in connection with the transaction.
- (j) There is no intercorporate indebtedness existing between Acquiring and Target that was issued, acquired, or will be settled at a discount.
- (k) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv) of the Code.
- (l) Acquiring does not own, directly or indirectly, nor has it owned during the past five years, directly or indirectly, any stock of Target.
- (m) In the transaction, none of the property transferred by Target to Acquiring will be subject to any liabilities and Acquiring will not assume any of Target's liabilities.
- (n) Target is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A) of the Code.
- (o) None of the compensation received by any shareholder-employees of Target will be separate consideration for, or allocable to, any of their shares of Target stock; none of the shares of Acquiring common stock received by any shareholder-employees will be separate consideration for, or allocable to, any employment agreement; and the compensation paid to any shareholder-employees will be for services actually rendered and will be commensurate with amounts paid to third parties bargaining at arm's-length for similar services.
- (p) Target's shareholders will not be in control of Acquiring immediately after the transaction for purposes of § 368(a)(1)(D) of the Code.
- (q) The proposed transaction is not a reorganization within the meaning of § 368(a)(1)(A) of the Code.

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

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- (1) The acquisition by Acquiring of substantially all of Target's assets in exchange solely for Acquiring voting common stock, as described above, followed by the distribution of the Acquiring common stock to the stockholders of Target in complete liquidation of Target, will be a reorganization within the meaning of § 368(a)(1)(C) of the Code. See § 1.368-1(d)(1); Rev. Rul. 85-197, 1985-2 C.B. 120; Rev. Rul. 85-198, 1985-2 C.B. 121; *Commissioner v. Gilmore's Estate*, 130 F.2d 791 (3d Cir. 1942), *aff'g* 44 B.T.A. 881 (1941), *acq.*, 1946-2 C.B. 2; *Commissioner v. Webster's Estate*, 131 F.2d 426 (5th Cir. 1942); *aff'g* 44 B.T.A. 881 (1941), *acq.*, 1946-2 C.B. 5. See also Rev. Rul. 88-48, 1988-1 C.B. 117. For purposes of this ruling, "substantially all" means at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets of Target. Acquiring and Target will each be "a party to the reorganization" within the meaning of § 368(b).
- (2) Target will recognize no gain or loss on the transfer of substantially all of its assets to Acquiring in exchange for Acquiring voting common stock. Section 361(a).
- (3) Target will recognize no gain or loss on its distribution of the Acquiring stock received in the Transfer to Target shareholders pursuant to the plan of reorganization. Section 361(c)(1).
- (4) Acquiring will recognize no gain or loss on the receipt of substantially all the assets of Target solely in exchange for Acquiring voting common stock. Section 1032(a).
- (5) Acquiring will succeed to and take into account, on the date of the proposed transfer (as defined in § 1.381(b)-1(b)), the applicable items of Target described in § 381(c), subject to the conditions and limitations specified in §§ 381, 382, 383, 384, and the regulations thereunder.
- (6) Acquiring will succeed to and take into account the earnings and profits, or deficit in earnings and profits, of Target as of the date of the transfer. Section 381(c)(2) of the Code and § 1.381(c)(2)-1 of the regulations. Any deficit in earnings and profits of Target will be used solely to offset earnings and profits accumulated after the date of the transfer.
- (7) Target shareholders will recognize no gain or loss on the exchange of their Target stock solely for Acquiring voting common stock. Section 354(a).
- (8) A Target shareholder's basis in the Acquiring stock received in the transaction will be the same as the basis of the Target stock such shareholder surrendered in exchange therefor. Section 358(a)(1).

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- (9) A Target shareholder's holding period in the Acquiring stock received in the transaction will, in each instance, include the period during which the stock of Target surrendered in exchange therefor was held, provided that the Target stock is held as a capital asset in the hands of the Target shareholder on the date of the exchange. Section 1223(1).

No opinion is expressed about the tax treatment of the 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 transaction that are not specifically covered by the above rulings. Specifically, no rulings were requested and no opinion is expressed about the federal income tax treatment of the distribution by Target of all of the Corp C stock to the Target ESOP in redemption of approximately u shares of Target stock.

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 letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling is consummated.

In accordance with a power of attorney on file in this office, we have sent a copy of this letter to the taxpayer.

Sincerely yours,
Assistant Chief Counsel (Corporate)

By Ken Cohen
Senior Technician Reviewer, Branch 3