Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Company =

Business X =

Class A Stock =

Class B Stock =

Class C Stock =

Class D Stock =

Individual A =

a =

b =

c =

d =

e =

f =

g =

h =

i =

k =

Date A =

Year B =

Dear :

This letter responds to your December 8, 1999, request for rulings under §§ 305 and 306 of the Internal Revenue Code. The information provided in that letter and later correspondence is summarized below.

Closely held Company is engaged in Business X and currently has one class of common stock outstanding. Individual A owns a percent of the stock, certain key employees own b percent, and various other entities and individuals own the remainder (the majority). Individual A's interest gives him, as a practical matter, operating control of Company.

Company wishes to give certain key employees an opportunity to acquire equity in Company at relatively low cost, while allowing Individual A to maintain operating control.

To accomplish these goals, Company proposes to recapitalize in the following manner:

(i) Company will authorize four new classes of stock: Class A, Class B, Class C, and Class D.

(ii) Each share of stock now outstanding that is not owned by Individual A will be exchanged for one share of newly issued Class A Stock.

(iii) Each share of stock owned by Individual A will be exchanged for one share of newly issued Class B Stock.

(iv) Shortly after these three steps (collectively, the "Transaction") are

completed, Company expects to issue Class C Stock, and grant options to acquire Class C Stock, to certain key employees.

Under the proposed plan, the Class A Stock will have a liquidation preference of c dollars per share. After recovery of this preference, the Class B Stock also will have a liquidation preference of c dollars per share. After recovery of both preferences, the Class C Stock and Class D Stock will receive pro rata an amount equal to the total capital paid in for stock of these two classes after the date of the Transaction. After recovery of the paid-in capital, the remaining proceeds will be shared among all classes pro rata. The aggregate of liquidation preferences for the Class A Stock and the Class B Stock is intended to approximate the fair market value of Company at the time of the Transaction. Company has no plan or intention to liquidate.

Also under the proposed plan, dividend payments are not required for any class of stock. Before any dividend may be paid on any class other than Class A Stock, however, a dividend of like amount must first be paid on the Class A Stock. Similarly, before any dividend may be paid on Class C Stock or Class D Stock, a dividend of like amount must first be paid on the Class B Stock. The policy followed by Company's board of directors over the past decade has been to pay annual dividends to Company shareholders equal to d percent of the average after-tax profits of Company for the preceding three years. Company plans to continue this policy in paying dividends on the Class A Stock and Class B Stock. Further, there is no plan, intention, or realistic likelihood that a Class A share will receive a dividend in excess of that received by a Class B share. Company anticipates that no dividends will be paid on the Class C Stock and Class D Stock.

All shares of the Class A Stock and/or all shares of the Class B Stock will be converted into Class C Stock and Class D Stock, respectively, should Company undertake an initial public offering ('IPO'), provided certain requirements are met. In addition, Class B Stock or Class D stock transferred to anyone other than Individual A or a trust controlled by Individual A will convert automatically into Class A Stock and Class C Stock, respectively. All conversions will be on a one-for-one basis, subject to standard antidilution adjustments to reflect subsequent stock splits, stock dividends, and recapitalizations. As of Date A, the likelihood of an IPO is highly contingent, and Individual A has no plan or intention to dispose of any Class B Stock he receives in the Transaction.

One-half of Company's board of directors will be elected by the Class A and Class C stockholders voting together as one class, and one-half will be elected by the Class B and Class D stockholders voting together as one class.

Immediately after the Transaction, Company expects to have outstanding e shares of Class A Stock and f shares of Class B Stock. Company further expects that an aggregate of g shares of Class C Stock will be issued as restricted stock or reflected

in option grants.

Currently, h shares of Company common stock are subject to certain repurchase rights and obligations (the "Restricted Stock"). For example, Company will purchase Restricted Stock from a holder or holder's estate in the event of death or termination of employment. The h shares of Class A Stock that will be exchanged for the Restricted Stock in the Transaction will also be subject to these rights and conditions. Further, each of the i holders of Restricted Stock may enter into a revised stock purchase agreement (the 'Revised Agreement') recently offered by Company. Under the Revised Agreement, a holder of Restricted Stock will have the right to require Company to purchase all or part of the holder's stock during certain periods beginning after Year B or after a public offering by, or business combination involving, Company. The majority of the Restricted Stock holders have already entered into the Revised Agreement, and all but k holders are expected to do so before, or shortly after, the Transaction.

After the proposed Transaction, shares of Class C Stock and options to acquire shares of Class C Stock generally will also be subject to terms and conditions limiting transferability and calling for Company redemption of shares in certain circumstances.

Except as described above, there will not be outstanding before the Transaction, and Company does not plan to have outstanding after the Transaction, any option, warrant, convertible debt, or other instrument or right pursuant to which any person has or will have a right to acquire stock from Company.

The taxpayer has made the following representations concerning the proposed transaction:

(a) Company and its shareholders each will pay its, his, or her own expenses, if any, incurred in the Transaction.

(b) The Transaction will qualify as a reorganization under § 368(a)(1)(E).

(c) Company has no plan or intention to redeem or otherwise reacquire any shares of Class A Stock or Class B Stock issued in the Transaction, other than as described above.

(d) The Transaction will be a single, isolated transaction and not part of a Company plan periodically to increase the proportionate interest of any shareholder in the assets or earnings and profits of Company.

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

(1) The Transaction will not be treated as a distribution of property to which § 301 applies by reason of the application of § 305(b) or (c).

(2) The Class A Stock and the Class B Stock received by exchanging shareholders in the Transaction will not be "section 306 stock" as that term is defined in § 306(c).

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.

The rulings contained in this letter are based upon the facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. Verification of the information, representations, and other data may be required as part of the audit process.

The rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) provides that they 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 during which the proposed Transaction is accomplished.

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

Sincerely yours,

Assistant Chief Counsel (Corporate)

by:_____
Wayne T. Murray
Senior Technical Reviewer
Branch 4