Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
September 7, 2000

Re:

Transferee =

Transferor 1 =

Transferor 2 =

Merger-Sub =

Target =

State A =

State B =

State C =

Business X =

Business Y =

System =

System Agreements =

Rights =

a percent =

b percent =

We respond to your request dated December 9, 1999, for rulings as to the federal income tax consequences of a proposed transaction. The information submitted in your request and in subsequent correspondence is summarized below.

Transferee is a newly formed State A corporation. Merger-Sub is a wholly owned subsidiary of Transferee, formed for the purpose of effectuating the proposed transaction. Transferor 1 is a State B corporation engaged in Business Y and is an affiliate of corporations engaged in Business X. Transferor 2 is a State C corporation also engaged in Business X. Transferee, Transferor 1, and Transferor 2 are accrual basis, calendar year taxpayers.

Target is a State A corporation engaged in Business Y. Target is an accrual basis, calendar year taxpayer.

Target has pursued a business strategy of establishing relationships with corporations engaged in Business X to develop its Business Y. The construction and operation of Target's System depend upon certain exclusive, indefeasible rights of use granted to Target (the Rights). The taxpayers have represented that there are valid business reasons for the following proposed transactions:

(i) Transferors 1 and 2 plan to transfer certain assets, including cash and depreciable personal property (the Assets), and the Rights to Transferee in exchange for voting common stock of Transferee, representing in the aggregate up to b percent of the outstanding shares of the Transferee common stock on a fully diluted basis (i.e. less than 80 percent of such stock). A portion of the Transferee stock to be received by Transferor 1 and Transferor 2 will be subject to restrictions that would require Transferor 1 and Transferor 2 to return a portion of the shares if they fail to make any of the subsequent transfers of property agreed to. No stock will be held in escrow. The taxpayers have represented that the terms of the restricted stock arrangement will comply with Rev. Proc. 77-37, 1977-2 C.B. 568, and Rev. Proc. 84-42, 1984-1 C.B. 521.

(ii) Transferee has formed a transitory subsidiary, Merger-Sub, all of whose

stock is owned by Transferee.

(iii) Merger-Sub will be merged with and into Target, with Target surviving. The shareholders of Target will receive shares of Transferee totaling 80 percent of Transferee common stock in exchange for their Target stock. The taxpayers have represented that, to the best of their knowledge and belief, this step will qualify as a reorganization under §368(a)(1)(A) of the Internal Revenue Code by reason of §368(a)(2)(E).

The taxpayers have made the following representations in connection with the proposed transaction:

(a) No stock or securities will be issued for services rendered to or for the benefit of the Transferee in connection with the proposed transaction, and no stock or securities will be issued for indebtedness of the Transferee that is not evidenced by a security or for the interest on indebtedness of the Transferee which accrued on or after the beginning of the holding period of the transferors for the debt.

(b) The transfer is not the result of the solicitation by a promoter, broker, or investment house.

(c) No liabilities of the Transferors will be assumed by the Transferee.

(d) There is no indebtedness between the Transferee and the Transferors, and there will be no indebtedness created in favor of the Transferors as a result of the proposed transaction.

(e) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.

(f) The transfer of assets will occur pursuant to the System Agreements and in a manner consistent with an orderly procedure in accordance with §1.351-1(a)(1) of the Income Tax Regulations.

(g) Except for the possible recission of the issuance of certain shares (comprising approximately a percent of the total shares of Transferee issued in the proposed transaction) for failure to make required transfers of property, there is no plan or intention on the part of the Transferee to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.

(h) Taking into account any issuance of additional shares of Transferee stock; any issuance of stock for services; the exercise of any Transferee stock rights, warrants, or subscriptions; a public offering of Transferee stock, and the sale, exchange, transfer by gift, or other disposition of any

of the stock (including the recission of a percent) of the Transferee to be received in the exchange, Transferor 1, Transferor 2, and the Target shareholders will be in "control" of the Transferee within the meaning of §368(c) of the Code.

(i) Transferor 1 and/or Transferor 2 are contemplating transferring some or all of their Transferee stock to respectively controlled subsidiaries.

(j) Each transferor will receive stock approximately equal to the fair market value of the property transferred to the Transferee.

(k) Transferee is contemplating transferring some or all of the assets received in the proposed transaction to Target, its soon-to-be wholly owned subsidiary.

(l) Except for Transferee's potential transfer of the assets to a wholly owned subsidiary, Target, the taxpayers represent that there is no plan or intention by the Transferee to dispose of the transferred property other than in the normal course of business operations. Property transferred to Target will be held by Target, and there is no plan or intent to dispose of the property except in the ordinary course of business.

(m) Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the proposed transaction, except Transferors 1 and 2 have agreed to reimburse Target for certain expenses in accordance with the guidelines set forth in Rev. Rul. 73-54, 1973-1 C.B. 187.

(n) Transferee will not be an investment company within the meaning of §351(e)(1) and §1.351-1(c)(1)(ii).

(o) The transferors are not under the jurisdiction of a court in a Title 11 or similar case (within the meaning of §368(a)(3)(A)) and the stock received in the exchange will not be used to satisfy the indebtedness of such debtors.

(p) Transferee will not be a "personal service corporation" within the meaning of §269A.

(q) To the best of the knowledge and belief of Transferor 1, Transferor 2, and Target, the transaction described in steps (i), (ii) and (iii), above, will qualify under §351 based on the rulings below.

Section 351 does not apply unless the transferor or transferors hold at least 80 percent of the stock of the transferee corporation after the transfer. In the present

case, after the transfers of the assets by Transferor 1 and Transferor 2, Transferor 1 and Transferor 2 will hold less than 80 percent of the common stock of Transferee. Accordingly, standing alone, Transferor 1's and Transferor 2's transfer of assets would not qualify for §351 treatment and would generate taxable gain for Transferor 1 and Transferor 2.

We note that Merger-Sub is a transitory entity. If Merger-Sub and its role in the reverse triangular merger is disregarded, Target's shareholders, in substance, have transferred property (Target stock) to Transferee in exchange for Transferee stock. Inasmuch as Congress adopted §368(a)(2)(E) to address the tax consequences of reverse triangular mergers, the tax consequences of that merger on the participants of that merger must flow from §368(a)(2)(E) rather than from §351. Nonetheless, solely for purposes of determining whether the 80 percent requirement has been met so as to qualify Transferor 1 and Transferor 2 for treatment under §351, Target's shareholders will be considered "transferors" as described in §351, and, accordingly, Target's shareholders' ownership of Transferee common stock will be included in the computation. The combined ownership of Transferor 1, Transferor 2, and the Target shareholders of Transferee, so computed, exceeds 80 percent.

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

(1) For purposes of § 351, the formation of Merger-Sub followed by the merger of Merger-Sub into Target will be treated as a transfer by the holders of the stock of Target to Transferee in exchange for Transferee stock (see Rev. Rul. 67-448, 1967-2 C.B. 144).

(2) No gain or loss will be recognized by Transferor 1 and Transferor 2 upon the transfer of the Assets solely in exchange for stock of Transferee (§351(a)).

(3) No gain or loss will be recognized by the Transferee upon the receipt of the Assets and Target stock from the transferors solely in exchange for Transferee stock (§1032(a)(1)).

(4) The basis of the Transferee stock to be received by Transferor 1 and Transferor 2 will be the same as the basis of the Assets exchanged therefor (§358(a)(1)).

(5) The holding period of the Transferee stock to be received by Transferor 1 and Transferor 2 will include, in each instance, the period during which the property exchanged therefor was held, provided such property was held as a capital asset by the transferors on the date of the exchange (§1223(1)).

(6) The basis of the Assets of Transferor 1 and Transferor 2 to be received by the Transferee will be, in each case, the same as the basis of such Assets

in the hands of the transferors (§362(a)).

(7) The holding period of the Assets of Transferor 1 and Transferor 2 to be received by the Transferee will include, in each instance, the period during which such Assets were held by the transferors (§1223(2)).

The rulings contained in this letter are based upon information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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. Specifically, we express no opinion as to whether or not step (iii) qualifies as a reorganization under §368(a)(1)(A) by reason of §368(a)(2)(E). Also, we express no opinion on the federal income tax treatment of the transfers by Transferor 1 and Transferor 2 to Transferee of the Rights. Specifically, no opinion is expressed as to whether such transfers constitute the transfer of "property." See Rev. Rul. 69-156, 1969-1 C.B. 101.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the specified authorized representative.

Sincerely yours,
Associate Chief Counsel (Corporate)
By: Filiz A. Serbes
Assistant to the Chief, Branch 5