Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

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Refer Reply To:
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Date:
March 14, 2001

Legend

Corporation =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Shareholder 6 =

Shareholder 7 =

Shareholder 8 =

Shareholder 9 =

Shareholder 10 =

Shareholder 11 =

Shareholder 12 =

Shareholder 13 =

Shareholder 14 =

Shareholder 15 =

Shareholder 16 =

Shareholder 17 =

Shareholder 18 =

Shareholder 19 =

Shareholder 20 =

Shareholder 21 =

Shareholder 22 =

Shareholder 23 =

Shareholder 24 =

Shareholder 25 =

Shareholder 26 =

Individual B =

Individual C =

a =

Trustee =

Re:

This letter responds to your request of October 16, 2000, supplemented by letters dated December 28, 2000, and February 7, February 13, February 15, February 23, and March 9, 2001, for rulings as to certain Federal income tax consequences of a proposed transaction. The facts as submitted are summarized below.

Corporation is a privately held corporation with two classes of stock outstanding, which are Class A and Class B common stock. The shares of the two classes are identical, except that only Class A shares have voting rights.

Shareholders 1 through 12 own Class A stock. Shareholders 13 through 26 own Class B stock. Shareholder 1 is a limited liability company taxed for Federal income tax purposes as a partnership. Two of the members of Shareholder 1 are Shareholders 22 and 23 (and prior to the transaction described below the remaining member of Shareholder 1, Individual C, does not directly own any Corporation stock); Shareholders 22 and 23 and Individual C are sisters. As part of the transaction outlined in steps (1) through (5) below, Shareholder 1 intends to distribute certain of its Corporation shares to its members in a non-liquidating distribution; assuming that this distribution occurs between Steps (2) and (3) described hereafter, any reference below, including in the rulings section, to Shareholder 1 or to the shareholders of Corporation generally shall also be to the distributees of the Corporation shares now held by Shareholder 1. Shareholder 2 is a trust, of which Individual B is considered the owner for Federal income tax purposes. Individual B and Shareholders 3 through 9 are members of the same family within the meaning of § 318(a)(1) of the Internal Revenue Code. Shareholder 4 is a revocable trust treated for Federal income tax purposes as owned by a particular member of that family. Shareholder 11 is a married couple that holds their stock certificate jointly, and Shareholder 26, who is one of those spouses, owns Class B stock individually. Shareholder 12 is a wholly-owned subsidiary of Corporation; no rulings have been requested with respect to Shareholder 12. Shareholder 23 is the chief executive officer and chairperson of the board of directors of Corporation.

Corporation and its shareholders intend to conduct, as part of an integrated plan, a transaction consisting of the following steps (not necessarily conducted in the order set forth):

(1) Corporation will establish an employee stock ownership plan ("ESOP") for the benefit of its employees;

(2) Corporation will redeem Class A stock and Class B stock on a pro rata basis from each Corporation shareholder;

(3) The Class B shareholders will exchange all their remaining Class B shares (after giving effect to Step (2)) with Corporation in return for Corporation's issuance of Class A shares (however, such shareholders will continue to be referred to in the rest of this letter as the Class B shareholders);

(4) Each Class A shareholder, except Shareholder 12, will sell a percent (after taking into account the effects of Step (2)) of his, her, or its Class A stock to the ESOP; and

(5) Each Class B shareholder will sell all of his, her, or its Class A stock received in

Step (3) to the ESOP.

Immediately after the transaction, the ESOP will not have allocated any Corporation stock to the ESOP participants and thus no potential beneficiary of the ESOP will, at that time, have the right to vote any of the ESOP's Corporation stock, the ability to direct disposition of any of the ESOP's Corporation stock, the right to receive dividends on any of the ESOP's Corporation stock, or the right to share in the net assets upon a liquidation of any of the ESOP's Corporation stock.

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

(a) There are no outstanding options or warrants to purchase Corporation stock, nor are there any outstanding debentures or other obligations that are convertible into Corporation stock or that would be considered Corporation stock.

(b) No notes or other obligations of Corporation will be distributed to a redeemed shareholder.

(c) No shareholder of Corporation has been or will be obligated to purchase any of the stock to be redeemed.

(d) The redemption described in this ruling request is an isolated transaction and is not related to any other past or future transaction.

(e) Corporation has no plan or intention to issue, redeem, or exchange additional shares of its stock.

(f) With respect to Corporation shareholders to which § 302(b)(3) may apply, none of the redeemed shareholders are related, within the meaning of § 318, to any remaining shareholders of Corporation.

(g) None of the stock to be redeemed is "section 306 stock" within the meaning of § 306(c) and was not received in exchange for preferred stock.

(h) There are no declared but unpaid dividends, or funds set apart for dividends, on any of the Corporation stock to be redeemed.

(i) Each Corporation shareholder will receive the same amount per share in step (2).

(j) Each Corporation shareholder will receive the same amount per share in steps (4) and (5).

(k) The ESOP will meet the definition of an ESOP set forth in § 4975(e)(7).

(l) For purposes of steps (4) and (5), Trustee will be the trustee of the ESOP and will negotiate and approve the ESOP's purchase of an interest in Corporation and confirm that the ESOP's treatment is in the best interests of the ESOP and its plan participants, in accordance with applicable fiduciary duties and other applicable rules.

(m) Each of the Corporation shareholders currently holds his, her, or its stock as a capital asset and has done so for more than 12 months.

(n) The transaction will be properly documented and valid under applicable state laws.

(o) At the time that steps (2), (4), and (5) occur, the fair market value of the consideration to be received by each redeemed Corporation shareholder will be approximately equal to the fair market value of the Corporation stock exchanged therefor.

(p) The price to be paid for the Corporation stock in steps (2), (4), and (5) will not result in a loss for any shareholder with respect to such shares of stock redeemed or sold.

Based solely on the information submitted (which includes the amount of Corporation Class A and Class B stock held by each of the shareholders described above) and representations made, we conclude as follows:

(1) The redemption by Corporation of a pro rata portion of its outstanding Class B common stock in step (2) will be treated as an integrated transaction with the exchange of B shares for A shares in step (3) and the sale of the remaining Class A shares in the ESOP sale so that such transactions will have the effect of a complete termination of all of such Class B shareholder's interest in Corporation within the meaning of § 302(b)(3) except with respect to the Class B common stock held by Shareholders 22, 23, and 26. See Zenz v. Quinlivan, 213 F.2d 914 (6th Cir. 1954). The amount of cash distributed to each Class B shareholder in step (2) (except to Shareholders 22, 23, and 26) will be treated either as a distribution in full payment for the stock surrendered as provided in § 302(a) or as a distribution under § 356 that does not have the effect of distribution of a dividend, whichever is applicable.

(2) Except for the redemption of the Class A common stock held by Shareholder 12, the redemption by Corporation of a pro rata portion of its outstanding Class A common stock and a pro rata portion of the Class B common stock held by Shareholders 22, 23, and 26 in Step (2) will be treated as an integrated transaction with the exchange of B shares for A shares in step (3) and the sale of the Class A shares to the ESOP so that such transactions will have the effect of a substantially disproportionate redemption of such Class A and Class B shareholders' interests within the meaning of § 302(b)(2). See Rev. Rul. 75-447, 1975-2 C.B. 113. The amount of cash distributed to each Class A shareholder (except Shareholder 12) in step (2) and to Shareholders 22, 23, and 26 with respect to their Class B common stock in step (2) will be treated either as a

distribution in full payment for the stock surrendered as provided in § 302(a) or as a distribution under § 356 that does not have the effect of distribution of a dividend, whichever is applicable.

(3) Assuming that § 341 (collapsible corporations) is not applicable and that the Corporation stock is a capital asset in the hands of each shareholder, gain will be considered capital gain subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code.

No opinion is expressed as to the qualification of any part of this transaction under § 1042. No opinion is expressed as to the tax results of the distributions of Corporation stock by Shareholder 1 to Shareholder 1's members. No opinion is expressed as to which of §§ 302(a) or 356 applies to a particular corporate distribution. No opinion is expressed as to whether step (3) qualifies as a tax-free recapitalization under § 368. No opinion is expressed about 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.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it 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 taxpayer involved for the taxable year in which the transaction covered by this letter is consummated.

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