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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:B05 - PLR-130959-01

Date:
July 17, 2001

In re:

Target =

Acquiring =

State A =

a =

b =

c =

d =

e =

Date A =

This is in reply to your letter dated May 24, 2001 requesting rulings on a proposed transaction. The facts submitted for consideration are substantially as set forth below.

Target is a publicly traded State A corporation. It is the common parent of an affiliated group of corporations that files a federal consolidated income tax return. Target uses an annual accounting period ending December 31 and the overall accrual method of accounting for filing its federal income tax return. Target has one active wholly owned subsidiary, and four inactive wholly owned subsidiaries.

As of Date A, Target had a shares of common stock outstanding. Its common stock is currently held by approximately b shareholders, and there are no other classes

of outstanding stock. Target's c largest shareholders currently own approximately d percent of Target's stock.

Pursuant to an overall, integrated plan and for valid business reasons, the following transaction has been proposed:

(i) Target will make a tender offer to all of its shareholders to acquire Target stock (the "Tender Offer"). The Tender Offer will be funded by a loan from a consortium of community banks ("Tender Offer Borrowing"). The Tender Offer is intended to increase the percentage stock ownership of Target's largest c shareholders from approximately d percent to an amount in excess of e percent.

(ii) Following the Tender Offer, Target's c largest shareholders (now owning over e percent of Target's common stock) will contribute their Target stock to Acquiring solely in exchange for Acquiring stock (the "Contribution").

(iii) Acquiring will then form a wholly owned subsidiary, which will merge into Target under applicable State A law (the "Merger"), with Target surviving the Merger. As a result of the Merger, all remaining Target shareholders other than Acquiring will receive cash (which is expected to be at the same price per share as in the Tender Offer). Acquiring will fund the purchase of the Target shares in the Merger through a borrowing from a newly formed subsidiary of Acquiring ("Merger Borrowing").

(iv) Following the Merger, Acquiring will elect under § 1362 of the Internal Revenue Code to be treated as an S Corporation, and Acquiring will make qualified subchapter S subsidiary ("QSub") elections under § 1.1361-3 of the Income Tax Regulations on behalf of Target and each of Target's subsidiaries. The QSub elections will result in the deemed liquidation of Target and its subsidiaries for U.S. federal income tax purposes (the "Liquidation").

In connection with the proposed transaction, Target, Acquiring, and the Target shareholders represent the following:

- (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.
- (b) During the 5-year period beginning on the date of the proposed transaction, there is no plan or intention for Acquiring, or any person related (as defined in § 1.368-1(e)(3)) to Acquiring, to acquire, with consideration other than Acquiring stock, Acquiring stock furnished in exchange for a proprietary interest in Target in the proposed transaction, either directly or through any transaction, agreement, or arrangement with any other person, except for cash in lieu of fractional shares distributed to

Target shareholders in the Merger.

- (c) During the 5-year period ending on the date of the proposed transaction, 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 for cash paid to dissenters.
- (d) The aggregate value of the acquisitions and distributions described above in (b) and (c) will not exceed 50 percent of the value (without giving effect to the acquisitions) of the proprietary interest in Target on the effective date of the proposed transaction.
- (e) The Tender Offer Borrowing and the Merger Borrowing will be repaid only from future earnings of Target or from capital contributions made to Target by Acquiring.
- (f) 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, provided that the Tender Offer Borrowing and the Merger Borrowing are not treated as reducing the net or gross assets acquired from Target in the transaction. For purposes of this representation, amounts paid by Target to dissenters, amounts paid by Target to shareholders who receive cash or other property, amounts used by Target to pay its reorganization expenses, 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.
- (g) After the transaction, Acquiring will be in control of Target within the meaning of § 368(a)(2)(H)(i).
- (h) Acquiring has no plan or intention to reacquire any of its stock constructively issued in the transaction.
- (i) Acquiring has no plan or intention to sell or otherwise dispose of any of the assets of Target acquired in the transaction, except for dispositions made in the ordinary course of business.
- (j) The liabilities of Target assumed (as determined under § 357(d)) by Acquiring in the transaction were incurred by Target in the ordinary course of its business and are associated with the assets transferred.

- (k) Following the transaction, Acquiring will continue the historic business of Target or use a significant portion of Target's historic business assets in a business.
- (l) At the time of the transaction, Target will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Target that, if exercised or converted, would affect Acquiring's acquisition or retention of control of Target, as defined in § 368(a)(2)(H)(i).
- (m) Target and Acquiring will pay their respective expenses, if any, incurred in connection with the transaction.
- (n) There is no intercorporate indebtedness existing between Target and Acquiring that was issued, acquired, or will be settled at a discount.
- (o) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (p) The total adjusted basis and the fair market value of the assets of Target transferred to Acquiring will equal or exceed the sum of the liabilities assumed (as determined under § 357(d)) by Acquiring.
- (q) Target is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

Based on the foregoing, we rule as follows:

- (1) For federal income tax purposes, the Contribution, Merger, and Liquidation will be treated as the transfer by Target of substantially all of its assets to Acquiring in exchange for Acquiring stock and the assumption by Acquiring of all of the liabilities of Target, followed by the liquidation of Target.
- (2) The acquisition by Acquiring of substantially all of the assets of Target in exchange for Acquiring stock and the assumption by Acquiring of the liabilities of Target followed by Target's distribution of the Acquiring stock in liquidation will constitute a "reorganization" within the meaning of § 368(a)(1)(D). 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 (with the Tender Offer Borrowing and the Merger Borrowing not treated as reducing the net or gross assets acquired from Target in the transaction). Target and Acquiring will each be a "party to a reorganization" within the meaning of

§ 368(b).

- (3) No gain or loss will be recognized by Target on the transfer of substantially all of its assets to Acquiring solely in exchange for Acquiring stock and the assumption by Acquiring of its liabilities (§§ 361(a) and 357(a)).
- (4) No gain or loss will be recognized by Acquiring on the receipt by Acquiring of Target's assets in exchange for shares of Acquiring stock (§ 1032).
- (5) No gain or loss will be recognized by Target upon the distribution of Acquiring stock to Target's shareholders (§ 361(c)(1)).
- (6) The basis of the assets of Target in the hands of Acquiring will be the same as the basis of those assets in the hands of Target immediately prior to the transaction (§ 362(b)).
- (7) The holding period for the assets of Target in the hands of Acquiring includes the period during which those assets were held by Target (§ 1223(2)).
- (8) No gain or loss will be recognized by the shareholders of Target on the exchange of their stock in Target for shares of Acquiring stock (§ 354(a)(1)).
- (9) The basis of the shares of Acquiring stock to be received by the Target shareholders will be the same as the basis of the Target stock surrendered in exchange therefor (§ 358(a)(1)).
- (10) The holding period of the Acquiring stock to be received by the Target shareholders will include the holding period of the Target stock surrendered in exchange therefor, provided the Target stock was held as a capital asset on the date of the exchange (§ 1223(1)).
- (11) The taxable year of Target will end on the effective date of the transaction (§ 1.381(b)-1(a) of the Income Tax Regulations), and as provided in § 381(a) and § 1.381(a)-(1), Acquiring will succeed to and take into account those attributes of Target described in § 381(c), subject to the provisions and limitations specified in §§ 381, 382, 383, and 384, if applicable, and the regulations thereunder.
- (12) Pursuant to § 381(c)(2) and § 1.381(c)(2)-1, 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 transfer. Any deficit in earnings and profits of either Target or Acquiring will be used only to offset the earnings and profits accumulated after the date of the transfer.

No opinion is expressed 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. In particular, no opinion is expressed whether Acquiring is an "ineligible corporation", as defined in § 1361(b)(2), at the time an election is made to treat such corporation as an S corporation and for any periods for which the election is effective. In addition, no opinion is expressed regarding the federal income tax consequences to the shareholders of Target other than Acquiring.

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

It is important that a copy of this letter be attached to the federal income tax return of the taxpayer involved for the taxable year in which the transaction covered by this ruling letter is consummated.

The rulings contained in this letter are based on the 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.

Sincerely yours,
Associate Chief Counsel (Corporate)
By: Debra Carlisle
Chief, Branch 5