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Department of the Treasury

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Person to Contact:

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Date:

July 29, 1999

Re:

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Dear :

This is in reply to a letter dated January 20, 1999, requesting rulings as to the federal income tax consequences of certain proposed transactions. Additional information was submitted by letter on July 7, 1999. The information submitted for consideration is substantially as set forth below.

Rulings contained in this letter are predicated upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of this request for ruling. Verification of the factual information, representations, and other data may be required as part of the audit process.

Company is a corporation engaged in an ongoing business. The outstanding stock of Company consists solely of D shares of voting common stock, of which E shares are owned by A, F are owned by B, F are owned by C, and G are owned by others. A, B, and C are unrelated to one another within the meaning of I.R.C. § 318(a).

Several integrated transactions are proposed. The business purpose for the integrated transactions is to provide key employees with incentive to increase the future value and profitability of Company. Common growth stock would be issued to essential management employees while the value in the stock held by inactive shareholders would be reduced. Thus, greater incentive would be provided to key employees to contribute to the growth of the company.

Pursuant to the integrated plan the following three steps will be taken: (1) the redemption of some of the Company common stock (the only Company stock at the time) from A, B, and C in exchange for their respective cash value life insurance policies currently owned by Company and possibly cash as well, (2) a recapitalization of Company converting the remaining shares of Company common stock into either: (a) voting common stock and non-voting non-convertible preferred stock or (b) solely nonvoting non-convertible preferred stock on a shareholder optional non-pro rata basis, and (3) the issuance of voting common stock to key employees, some of whom could be new shareholders.

More specifically the three steps will proceed as follows. In the first step of the integrated transactions Company proposes to redeem some shares of common stock from A, B, and C. In the event that the value of the life insurance is insufficient to support a substantially disproportionate redemption, Company would use cash to redeem the additional shares necessary for a substantially disproportionate redemption.

In the second step of the integrated transactions, Company will effect a recapitalization by giving the shareholders the option to exchange each share of their unredeemed common stock for either: (1) a package of 1 share of new common plus no more than H of a share of new preferred stock or (2) no new common stock but instead I of a share of new preferred stock. The preferred stock will have a value close to the total value of Company remaining after the redemption of common stock from A, B, and C. It is estimated that the new voting common would have little, if any current value. Each share of existing common stock would be equivalent to H of a share of preferred stock. As noted above shareholders electing to receive solely preferred stock for each share of their old common will receive I of a share of new preferred stock in exchange for each share of old common stock. This reflects a J % bonus as an inducement to take all preferred stock. Shareholders electing to receive common stock and preferred stock will receive one share of new common for each share of old common plus some new preferred which would be no more than H of a share of preferred for each share of old common but could be less. Because the total number of preferred shares will be fixed at K shares, shareholders electing to receive all preferred stock for their old common will receive their new preferred ahead of shareholders taking a mix of new common and new preferred so that the later shareholders will share on a pro rata basis the remaining new preferred shares.

In the third and final step of the integrated transactions, Company plans to issue shares of common stock to key employees so that these shareholders have at least O% of the outstanding common stock of Company after the integrated transactions.

Stock ownership of the Company before the integrated transactions:

<u>Shareholders</u>	<u>Shares</u>	<u>%</u>
A	E	L
B	F	M
C	F	M
Others	G	N
Key Employees	O	
Total Shares	D	

In connection with the proposed transaction, the following representations have been made:

(A) There are no outstanding options or warrants to purchase Company stock, nor are

there any outstanding debentures or other obligations that are convertible into Company stock or would be considered Company stock.

(B) The shareholders and creditors, if any, of Company are unrelated pursuant to section 318(a) of the Code.

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

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

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

(F) There have been no redemptions, issuances, or exchanges by Company of its stock in the past 5 years, with the exception of a redemption made upon the death of a shareholder.

(G) With exception of the contemplated transactions, Company has no plan or intention to issue, redeem, or exchange additional shares of its stock. The proposed integrated transactions are isolated transactions and not part of any plan to increase periodically the proportionate interest of any shareholder in the assets or earnings and profits of the Company (as such terms are used in section 1.305-7(c) of the regulations).

(H) None of the stock to be redeemed is "section 306 stock" within the meaning of section 306(c) of the Code.

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

(J) The new shareholders are not related, in any way to the redeemed shareholders under section 318(a) of the Code.

(K) At the time of the step 1 exchange, the fair market value of the consideration to be received by the redeemed shareholders will be approximately equal to the fair market value of Company's stock to be exchanged therefor.

(L) The price to be paid for Company's stock to be redeemed will not result in a loss with respect to those shares of stock.

(M) The redemption of Company's stock (i) is not a disposition of personal property on the installment plan by a person who regularly sells or otherwise disposes of personal property on the installment plan and (ii) is not a disposition of personal property of a

kind required to be included in the inventory of any redeemed shareholder at the close of the taxable year. Any note or other obligation to be issued to a redeemed shareholder will not be issued in any form designed to render it readily tradable on an established securities market.

(N) The percentage of outstanding Company common stock (voting and nonvoting) owned by A immediately after the integrated transactions will be less than 80% of the percentage of outstanding Company common stock (voting and nonvoting) (L%) owned by A immediately before the integrated transactions.

(O) The percentage of outstanding Company common stock (voting and nonvoting) owned by B immediately after the integrated transactions will be less than 80% of the percentage of outstanding Company common stock (voting and nonvoting) (M%) owned by B immediately before the integrated transactions.

(P) The percentage of outstanding Company common stock (voting and nonvoting) owned by C immediately after the integrated transactions will be less than 80% of the percentage of Company common stock (voting and nonvoting) (M%) owned by C immediately before the integrated transactions.

(Q) The proposed recapitalization is a reorganization described in section 368(a)(1)(E).

Based solely on the information submitted and the representations set forth above, it is held as follows:

(1) The integrated transactions result in a substantially disproportionate redemption of stock from A, B, and C under section 302(b)(2) of the Code. See Rev. Rul. 75-447, 1975-2 C.B. 113. The redemption will be treated as a distribution in full payment in exchange for the stock redeemed as provided in section 302(a).

(2) As provided in section 1001, gain will be realized and recognized by A, B, and C measured by the difference between the redemption price and the adjusted basis of the shares of Company stock surrendered as determined under section 1011. Provided section 341 (relating to collapsible corporations) is not applicable and the stock is a capital asset in the hands of A, B, and C, the gain will constitute capital gain subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code.

(3) As provided in section 1001 of the Code, any gain realized and recognized by Company, as a result of section 311(b) of the Code, will be measured by the difference between the fair market value and the adjusted basis of the insurance policies surrendered in the hands of Company (as determined under section 1011 of the Code).

(4) The gain, if any, recognized by Company will be capital gain subject to the

provisions and limitations of Subchapter P of Chapter 1 of the Code.

(5) The proposed exchange by A, B, C, and others of each share of Company common stock for Company common and preferred or 1 of a share of Company preferred stock will not be treated as a distribution of property to which section 301 applies by reason of the application of sections 305(b) and (c) of the Code, but will be a distribution to which section 305(a) applies. See section 1.305-7(c) and section 1.305-3(e) (Example (12)). See also Rev. Rul. 86-25, 1986-1 C.B. 202.

(6) The preferred stock received by A, B, and C in the integrated transactions will not be "section 306 stock" within the meaning of section 306(c) of the Code. See section 1.306-3(a) and (d). See also Rev. Rul. 81-186, 1981-1 C.B. 85.

The above rulings are effective to the extent the amount distributed to A, B, and C represents the fair market value of the shares of stock of Company exchanged. No opinion is expressed as to the tax effect of the amount, if any, the distribution by Company exceeds or is less than the fair market value of the stock exchanged. A determination of fair market value of the stock is reserved until the federal income tax returns of the taxpayers concerned have been filed for the tax year the transactions are consummated.

No opinion is expressed about the tax treatment of the transactions 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. In particular we express no opinion regarding whether the recapitalization will qualify as a reorganization under section 368(a)(1)(E) of the Code.

This ruling is directed only to the taxpayers who requested 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 returns of the taxpayers involved for the tax year in which the transactions covered by this ruling letter are consummated.

Sincerely,

By _____
Alfred C. Bishop
Chief, Branch 1