

Internal Revenue Service

Number: **200709013**

Release Date: 3/2/2007

Index Number: 1001.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:B02

PLR-125421-06

Date:

November 22, 2006

Legend

Parent =

Company =

Company LLC=

Holdco LLC =

Preferred Holdco =

Buyer =

Business A =

Business B =

Business C =

State A =

State B =

Date 1 =

Date 2 =

PLR-125421-06

Date 3 =

Date 4 =

Date 5 =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

n =

o =

Issue Date 1 =

Issue Date 2 =

Issue Date 3 =

Issue Date 4 =

PLR-125421-06

Maturity Date 1 =

Maturity Date 2 =

Maturity Date 3 =

Maturity Date 4 =

Act =

Dear _____ :

This is in response to a letter dated May 12, 2006, and subsequent correspondence, in which you requested rulings as to certain federal income tax consequences of the proposed transaction (defined below).

FACTS

Prior to Date 1, Company was a State A corporation and a wholly-owned subsidiary of Parent, the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Company, directly and through its subsidiaries, engages in Business A, Business B and Business C both within the United States and internationally.

As of Date 2 (which occurs prior to Dates 1 and 3), Company and its subsidiaries reported approximately \$a of indebtedness outstanding on its audited consolidated financial statements. A significant amount of Company's debt is unsecured and publicly traded. In particular, the following publicly traded debt instruments were issued by Company (collectively referred to herein as the "Debt"):

- (a) Notes with an aggregate principal amount of approximately \$b issued on Issue Date 1 and maturing on Maturity Date 1. The notes pay interest semi-annually in arrears at a rate of f percent.
- (b) Notes with an aggregate principal amount of approximately \$c issued on Issue Date 2 and maturing on Maturity Date 2. The notes pay interest semi-annually in arrears at a rate of g percent.
- (c) Notes with an aggregate principal amount of approximately \$d issued on Issue Date 3 and maturing on Maturity Date 3. The notes pay interest semi-annually in arrears at a rate of h percent.

PLR-125421-06

- (d) Notes with an aggregate principal amount of approximately \$e issued on Issue Date 4 and maturing on Maturity Date 4. The notes pay interest monthly at a rate of i percent.

The current trading price of one or more series of the Debt is less than its respective adjusted issue price. The Debt is recourse to Company, and none of Company's assets is subject to any perfected or unperfected security interest benefiting any of the holders of any series of the Debt. There are no provisions in the terms of the Debt that restrict Company's ability to acquire and dispose of assets in the ordinary course of its business. Each series of the Debt is governed by the terms of an indenture which prohibits Company from selling or conveying "all or substantially all" of its assets to any person unless the purchaser or transferee of such assets assumes the Debt and certain other requirements are satisfied. The terms of the Debt provide that State B law is applicable to all of Company's indentures.

Proposed Transaction

On Date 3 (which occurs prior to Date 1), Parent, Company, Holdco LLC and Buyer entered into an agreement pursuant to which Buyer would acquire a common equity interest of g percent in Company. To accomplish this acquisition, the following transaction steps have been or will be taken (transaction steps (i) through (vi) will be collectively referred to as the "Proposed Transaction"):

- (i) On Date 1, Company converted into Company LLC, a single member State A limited liability company (LLC), by filing a certificate of conversion under the Act (the "Company Conversion"). Effective as of the date of its conversion, Company LLC elected to remain taxable as a corporation for federal income tax purposes.
- (ii) On Date 4, Company LLC distributed certain assets to Parent, and Parent assumed certain liabilities of Company LLC.
- (iii) On Date 5, Company LLC's election to be treated as a disregarded entity for federal tax purposes will become effective.
- (iv) Following Date 5 and prior to the closing date, Company LLC will distribute cash and certain assets to Parent (and Parent will assume certain liabilities of Company LLC), and Parent will contribute \$j to Company LLC in exchange for newly-issued preferred units.
- (v) Following Date 5 and prior to the closing date, Parent will contribute \$k cash to Preferred Holdco, a wholly-owned subsidiary of Parent, and Preferred Holdco will contribute \$k cash to Company LLC in exchange for newly-issued preferred units. As a result of this step, Company LLC's

PLR-125421-06

classification will change from a disregarded entity to a partnership for federal income tax purposes.

- (vi) On the closing date, Parent will (a) sell o percent of its common interests in Company LLC to Buyer in exchange for a cash payment and (b) contribute all of its preferred units to Preferred Holdco. In addition, Buyer will contribute \$l to Company LLC for newly-issued preferred units. It is intended that, as a result of the actions described in this step (vi), Company LLC will terminate as a partnership for purposes of section 708(b)(1)(B) of the Internal Revenue Code.

Immediately after the closing date of the Proposed Transaction, the assets and liabilities of Company LLC will be identical to the assets and liabilities of Company immediately prior to converting to an LLC (other than assets acquired or disposed of, and liabilities incurred or satisfied, in the ordinary course of business), except that Company LLC, after electing conversion to an LLC but prior to the closing date, will distribute to Parent cash and other assets in a net amount that represents less than m percent of the book value of Company LLC's assets, subject to liabilities representing less than n percent of Company LLC's consolidated liabilities (after taking into account cash contributed to Company LLC in exchange for newly issued preferred units pursuant to steps (iv) through (vi)) (the "Net Distribution"). Applying State B law, the Net Distribution would not trigger the above described restriction in the indentures governing the Debt.

Pursuant to the Act, none of the Debt holders' rights against Company, including with respect to payments and remedies, and none of Company's obligations and covenants to the Debt holders will be altered in any manner by the Proposed Transaction. Following the Proposed Transaction, the Debt holders will continue to have exactly the same legal relationship with Company LLC that they previously had with Company, viz., as general unsecured recourse claimants having no greater preference than any other creditor. Additionally, under State A law, the restructuring will not result in the creation of any new legal rights or obligations between the Debt holders and Company LLC. There are no provisions in the original terms of the Debt that require the consent or approval of any holder of any series of the Debt in order for Company to effectuate the Proposed Transaction.

Representations

Parent and Company make the following representations:

1. The Company Conversion, followed by an election by Company LLC to be treated as an association taxable as a corporation for federal tax purposes

PLR-125421-06

effective as of the date of conversion, is intended to qualify as a reorganization under section 368(a)(1)(F) of the Code.

2. Parent, on the date of adoption of Company's plan of conversion (which is considered to be Date 3), and at all times thereafter until the deemed liquidation is completed, will be the owner of at least 80 percent of the single outstanding class of Company stock.
3. No shares of Company stock will have been redeemed during the 3 years preceding the adoption of the plan of conversion of Company on Date 3 or between that date and the date the deemed liquidation is completed.
4. Company has adopted a plan of conversion specifying that the final deemed liquidating distribution is to be completed within 3 years from the close of the taxable year of Company in which the first liquidating distribution is made.
5. As soon as the final liquidating distribution has been deemed made, Company will cease to exist for federal income tax purposes.
6. Company will, for federal income tax purposes, retain no assets following the deemed liquidating distribution.
7. Company will not have acquired assets in any nontaxable transaction at any time, except for--(i) contributions to capital from Parent and (ii) acquisitions occurring more than 3 years prior to the date of the adoption of the plan of conversion.
8. Other than the sale of an interest in a former subsidiary to unrelated purchasers, and the distribution to Parent described in step (ii) of the Proposed Transaction, no assets of Company have been, or will be, disposed of by either Company or Parent except for dispositions in the ordinary course of business and dispositions occurring more than 3 years prior to adoption of the plan of conversion.
9. Other than what may be deemed to occur in connection with steps (v) and (vi) of the Proposed Transaction, the liquidation of Company will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation ("Recipient") of any of the businesses or assets of Company, if persons holding, directly or indirectly, more than 20 percent in value of the Company stock also hold, directly or indirectly, more than 20 percent in value of the stock in Recipient. For purposes of this representation, ownership will be determined by application of the constructive ownership rules of section 318(a) of the Code, as modified by section 304(c)(3).

PLR-125421-06

10. Prior to the date the deemed liquidation is completed, no assets of Company will have been distributed in kind, transferred, or sold to Parent, except for (1) transactions occurring in the normal course of business, (2) the distribution described in step (ii) of the Proposed Transaction, and (3) transactions occurring more than 3 years prior to adoption of the plan of conversion.
11. Company will report all earned income represented by assets that will be distributed to Parent such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.
12. The fair market value of the assets of Company will exceed its liabilities both at the date of the adoption of the plan of conversion and immediately prior to the time the first liquidating distribution is made.
13. Parent is not an organization that is exempt from federal income tax under section 501 or any other Code provision.
14. All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the proposed deemed liquidation of Company have been fully disclosed.
15. The \$k cash contributed by Parent to Preferred Holdco in step (v) of the Proposed Transaction and the fair market value of the preferred units contributed by Parent to Preferred Holdco in step (vi) of the Proposed Transaction will, in the aggregate, equal less than 10 percent of the net fair market value of Company immediately before the date of adoption of the plan of conversion.
16. Parent and Company will treat the distribution of assets (and the related assumption of liabilities) from Company to Parent, as described in step (ii) of the Proposed Transaction, as made in connection with the complete deemed liquidation of Company.
17. The Proposed Transaction, whether by operation of the terms of the Debt or otherwise, will not change the yield on the Debt, will not change the timing of payments on the Debt, will not result in the addition or subtraction of co-obligors or guarantors to the Debt, will not change the collateral or security of the Debt, will not change the priority of the Debt, and will not otherwise alter the legal rights or obligations of Company with respect to the Debt.

LAW AND ANALYSIS

Section 301.7701-3(g)(1)(iii) of the Income Tax Regulations provides that if an eligible entity classified as an association elects under section 301.7701-(c)(1)(i) to be disregarded as an entity separate from its owner, the association is deemed to distribute all of its assets and liabilities to its single owner in liquidation of the association.

Section 301.7701-3(g)(2) provides that the tax treatment of a change in classification of an entity by election under section 301.7701-(c)(1)(i) is determined under all relevant provisions of the Code and general principles of tax law, including the step-transaction doctrine.

Section 1001 of the Code provides for the recognition of gain or loss on the sale or exchange of property. Section 1.1001-1(a) provides that gain or loss is realized from the exchange of property for other property differing materially either in kind or in extent.

Section 1.1001-3(b) provides that a debt instrument differs materially in kind or in extent if it has undergone a "significant modification." A significant modification of a debt instrument results in a "new" debt instrument that is deemed to be exchanged for the unmodified debt instrument.

Section 1.1001-3(c) provides rules for determining whether a change in the legal rights or obligations of a debt instrument is a modification. Pursuant to section 1.1001-3(c)(1)(i), a modification means any alteration, including any deletion or addition, in whole or in part, of a legal right or obligation of the issuer or a holder of a debt instrument, whether the alteration is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise.

Section 1.1001-3(c)(1)(ii) provides that, except as provided in paragraph (c)(2), an alteration of a legal right or obligation that occurs by operation of the terms of a debt instrument is not a modification.

Section 1.1001-3(c)(2)(i) provides that an alteration that results in the substitution of a new obligor, the addition or deletion of a co-obligor, or a change (in whole or in part) in the recourse nature of the debt instrument (from recourse to nonrecourse or from nonrecourse to recourse) is a modification, even if the alteration occurs by operation of the terms of a debt instrument.

Section 1.1001-3(e) provides rules for determining whether a modification is significant. Section 1.1001-3(e)(4)(i)(A) provides that except as provided in paragraphs (B), (C), or (D) of that section, the substitution of a new obligor on a recourse debt

PLR-125421-06

instrument is a significant modification. Section 1.1001-3(e)(4)(i)(B) provides that the substitution of a new obligor is not a significant modification if the acquiring corporation becomes the new obligor pursuant to a transaction to which section 381(a) applies, the transaction does not result in a change in payment expectations, and the transaction does not result in a significant alteration. Section 1.1001-3(e)(4)(i)(C) provides that the substitution of a new obligor is not a significant modification if the new obligor acquires substantially all of the assets of the original obligor, the transaction does not result in a change in payment expectations, and the transaction does not result in a significant alteration.

A change in payment expectations occurs if either of the following occurs: (1) there is a substantial enhancement of the obligor's capacity to meet the payment obligations under a debt instrument and that capacity was primarily speculative prior to the modification and is adequate after the modification; or (2) there is substantial impairment of the obligor's capacity to meet the payment obligations under the debt instrument that was adequate before the modification and is primarily speculative after the modification. Section 1.1001-3(e)(4)(vi). The preamble to final regulations under section 1001 further clarifies that "there is no change in payment expectations . . . if the obligor has at least an adequate capacity to meet its payment obligations both before and after the modification." 61 Fed. Reg. 32926, 32929 (June 26, 1996).

Generally, the federal tax law looks to state law to determine legal entitlements in property. Aquilino v. United States, 363 U.S. 509, 513 (1960); Morgan v. Commissioner, 309 U.S. 78, 82 (1940).

Section 18-214(e) of the Act provides that for State A law purposes, the conversion of any other entity into a domestic limited liability company shall not be deemed to affect any obligations or liabilities of the other entity incurred prior to its conversion to a domestic limited liability company or the personal liability of any person incurred prior to such conversion. Moreover, section 18-214(f) of the Act provides, inter alia, that for all purposes of State A law, all rights of creditors and all liens upon any property of the other entity that has converted shall be preserved unimpaired, and all debts, liabilities and duties of the other entity that has converted shall thenceforth attach to the domestic limited liability company and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it.

Several steps of the Proposed Transaction involve the substitution of a new obligor on the Debt, resulting in a "modification" of the Debt within the meaning of section 1.1001-3(c)(2)(i). Under section 1.1001-3(e)(4)(i)(A) of the regulations, this modification is a significant modification except as provided in paragraphs (B), (C), or (D) of that section. In the present case, each step of the Proposed Transaction in which a new obligor is substituted will qualify for an exception under paragraph (B) or (C) of

section 1.1001-3(e)(4)(i). Accordingly, the Proposed Transaction will not result in a significant modification of the Debt under section 1.1001-3(e) of the regulations.

RULINGS

Based on the information submitted and the representations made by Parent and Company set forth above, we rule as follows with respect to the Proposed Transaction:

1. The change in classification of Company, pursuant to election under section 301.7701-3(c)(1)(i), from an association classified as a corporation into a disregarded entity (the "Classification Change"), will qualify as a complete liquidation of Company into Parent under section 332 (section 332(b)) of the Code.
2. No gain or loss will be recognized by Parent or Company as a result of the Classification Change. Sections 332(a), 336(d)(3), 337(a) and 337(b). However, items of income, gain, loss, and deduction with respect to any intercompany indebtedness between Parent and Company will be taken into account as required by the applicable intercompany transaction regulations.
3. Parent's basis in each asset deemed received from Company as a result of the Classification Change will be the same as the basis of that asset in the hands of Company immediately before the Classification Change. Section 334(b)(1).
4. Parent's holding period in each asset deemed received from Company as a result of the Classification Change will include the period during which that asset was held by Company. Section 1223(2).
5. As a result of the Classification Change, Parent will succeed to and take into account the items of Company described in section 381(c), subject to the conditions and limitations specified in sections 381, 382, 383, and 384 and the regulations thereunder.
6. Parent will succeed to and take into account the earnings and profits, or deficit in earnings and profits, of Company as of the date of the Classification Change (section 381(c)(2)(A); section 1.381(c)(2)-1). Any deficit in the earnings and profits of Company or Parent will be used only to offset earnings and profits accumulated after the date of the liquidation (section 381(c)(2)(B)). Notwithstanding the above, to the extent that Company's earnings and profits are reflected in Parent's earnings and profits, the Company earnings and profits to which Parent succeeds must be adjusted to prevent duplication (section 1.1502-33(a)).

7. The Proposed Transaction will not result in a significant modification of the Debt under section 1.1001-3(e) of the regulations.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed regarding the tax effect that the Proposed Transaction may have on debt issued by Company other than the Debt that is the subject of ruling (7) above.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives. A copy of this letter must be attached to any federal income tax return to which it is relevant.

Sincerely,

David B. Silber
David B. Silber
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)