

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

December 3, 2001

Taxpayer =

State X =

Z =

Property =

Activities =

Date 1 =

Year 2 =

a =

b =

c =

We respond to your letter dated April 3, 2001, requesting rulings on the federal income tax consequences of a proposed transaction. The information submitted in your request and in subsequent correspondence is summarized below.

Taxpayer is a State X trust subject to tax as a Subchapter C corporation for federal income tax purposes. Taxpayer uses the accrual method of accounting, and its annual accounting period ends each year on Date 1.

Taxpayer was organized by lineal descendants of Z in Year 2 for the purchase and preservation of certain Property, in accordance with a bequest by Z. In addition,

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over the years, Taxpayer has come to conduct Activities. Under the terms of the trust instrument, Taxpayer has authorized capital stock. Taxpayer currently has outstanding one class of privately-held voting shares, which are nontransferable and lapse upon the holder's death. Currently, there are a shareholders, each of whom owns one share. The outstanding shares are evidenced by certificates, and Taxpayer maintains a registry of its shareholders.

Shareholders' rights are established and governed by the Declaration of Trust, which serves as bylaws and was created by the original organizing trustees of Taxpayer. Any lineal descendant of Z over the age of 21 may apply to the trustees for issuance of a share of Taxpayer's capital stock. Under the terms of the trust instrument, shares may be held only by lineal descendants of Z and their surviving spouses. Each shareholder is entitled to the use and enjoyment of the Property in accordance with the reasonable rules and regulations established by the trustees and to rights of priority in leasing certain trust property (collectively, the Non-Equity Rights).

Shareholders are entitled to vote at all regular and special meetings of Taxpayer and to nominate candidates for trusteeships. All but one of the b trustees must be lineal descendants of Z. The Declaration of Trust vests the power to amend the Declaration of Trust in the trustees, subject to certain rights retained by the shareholders, including liquidating the trust, increasing the number of trustees not to exceed c, leasing trust property to certain non-shareholders, and sales and exchanges of certain trust property. Each shareholder is entitled to a ratable portion of any proceeds from the liquidation of the trust (collectively, the Equity Interests).

For valid business purposes, under State X law, the existing shareholders of Taxpayer wish to organize a new State X nonprofit membership corporation (Newco) that will continue to be taxable as a Subchapter C corporation for federal income tax purposes. To accomplish this intent, Taxpayer will merge with and into Newco under State X law. Each shareholder of Taxpayer will exchange his or her one share of Taxpayer capital stock for one membership interest in Newco. The membership interests in Newco received in the exchange will have substantially the same voting rights and other rights as the shares in Taxpayer's capital stock and also will be nontransferable and lapse upon the holder's death. The holders of Newco membership interests will continue to share ratably in the proceeds of any liquidation of Newco.

Section 3.01(29) of Rev. Proc. 2001-3, 2001-1 I.R.B. 111, 114, provides that the Service will not rule on the qualification of a transaction as a reorganization under § 368(a)(1)(F). However, the Service will rule on a transaction involving a significant issue that is not clearly and adequately addressed by published authority. Taxpayer has made the following representations in connection with addressing the significant issue of whether there are any changes in identity of shareholders, in their proprietary interests between the old corporation and the new corporation, and in the assets of the corporation in the proposed transaction (see Rev. Rul. 66-284, 1966-2 C.B. 115; Helvering v. Southwest Consolidated Corp., 315 U.S. 194 (1942)):

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- (a) The fair market value of the membership interest in Newco received by each shareholder of Taxpayer will be equal to the fair market value of the share of Taxpayer surrendered in the exchange.
- (b) The membership interests in Newco received in the exchange will be nontransferable, except for transfer to Newco for cancellation. To the best knowledge of Taxpayer, there is no plan or intention by the current shareholders of Taxpayer, who will be the future Newco members, to transfer their membership interests to Newco for cancellation. Further, Taxpayer has no plan or intention to reacquire or redeem, either directly or indirectly, any Newco membership interests resulting from the exchange.
- (c) After the exchange, Newco will continue the operations that Taxpayer currently conducts. There is no plan or intention to sell or otherwise dispose of any of the assets of Taxpayer, except for dispositions made in the ordinary course of business.
- (d) Taxpayer and its shareholders will pay their respective expenses, if any, incurred in connection with the exchange.
- (e) Taxpayer is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).
- (f) The Articles of Organization and the Bylaws of Newco will apply to the members of Newco in the same way that the Declaration of Trust of Taxpayer applies to the shareholders of Taxpayer. Further, the shareholders currently holding Non-Equity Rights in Taxpayer immediately prior to the proposed transaction will hold, with no material change, the Non-Equity Rights in Newco immediately after the proposed exchange.

Although the Non-Equity Rights are associated with each equity share of Taxpayer's currently outstanding capital stock, the Non-Equity Rights are not attributes of equity, and we have deemed a separation of the Equity Interests and Non-Equity Rights for analytical purposes. Thus, based solely on the information submitted, the representations set forth above, and the deemed separation of Equity Interests and Non-Equity Rights, we hold as follows:

- (1) The exchange by the shareholders of Taxpayer of their shares in Taxpayer for membership interests in Newco qualifies as a reorganization under § 368(a)(1)(F). A shareholder will not recognize any gain or loss on the deemed exchange of his or her Equity Interest in Taxpayer for an Equity Interest in Newco (§ 354(a)(1)). Further, a shareholder will not realize any gain or loss on the deemed exchange of his or her Non-Equity Rights in Taxpayer for Non-Equity Rights in Newco (§ 1001).

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- (2) Taxpayer will not recognize any gain or loss on the exchange (§§ 361(a) and 357(a)). The basis of the assets of Taxpayer in the hands of Newco will be the same as the basis of such assets in the hands of Taxpayer immediately prior to the proposed transaction (§ 362(b)). The holding period of the Taxpayer assets held by Newco will include the period during which such assets were held by Taxpayer (§ 1223(2)).
- (3) The basis of the new membership interests in Newco to be received by the shareholders of Taxpayer will be the same as the basis of the shares of Taxpayer surrendered in exchange therefor (§ 358(a)(1)). The holding period of the new membership interests in Newco to be received by the shareholders of Taxpayer will include the period during which the shares of Taxpayer surrendered therefor were held, provided that the shares are held as capital assets on the date of the exchange (§ 1223(1)).

We express no opinion as to the federal income tax treatment of the proposed transaction under other provisions of the Code and regulations or 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.

This ruling is directed only to the taxpayers 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 returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to the taxpayer's authorized representative.

Sincerely yours,
Filiz A. Serbes
Chief, Branch 3
Office of Associate Chief Counsel
(Corporate)