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Department of the Treasury

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Date:

September 4, 2002

Corporation =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Shareholder F =

Shareholder G =

Shareholder H =

Shareholder I =

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Shareholder J =

Shareholder K =

Shareholder L =

Shareholder M =

Shareholder N =

Shareholder O =

Shareholder P =

Shareholder Q =

Shareholder R =

Shareholder S =

Shareholder T =

Shareholder U =

State A =

Brand X =

Company X =

X shares =

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Y shares =

x% =y% =z% =

Year A =

Year B =

Year C =

Year D =

Year E =

Date A =

a shares =b shares =c shares =d shares =e shares =f shares =g shares =h shares =i shares =j shares =k shares =l shares =

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m shares =n shares =o shares =p shares =q shares =r shares =s shares =t shares =u shares =v shares =w shares =x shares =\$a =

Dear :

This letter responds to the Corporation's May 1, 2002 request for rulings concerning the federal income tax consequences of a proposed transaction. The information submitted for consideration is summarized below.

Corporation is incorporated in State A and is the state-wide distributor of Brand X. It uses an accrual method of accounting and computes income on a calendar year basis for federal income tax purposes. Corporation has outstanding two classes of stock, X shares of Class A voting common stock and Y shares of Class B non-voting common stock. The Class A voting common stock is currently voted according to a Voting Trust Agreement. Under the Voting Trust Agreement, Shareholder F and Shareholder M are assigned the vote of all of the Corporation's Class A voting common stock. As trustees under the Voting Trust Agreement, Shareholder M votes x% of the shares while Shareholder F votes y% of the shares. All of the shareholders of the Corporation are the descendants of the founder, their spouses and/or trusts established

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for their benefit.

In Year A, Company X informed Corporation of a change in policy regarding the distribution of Brand X. The new policy is informally characterized as a “single set of eyes” theory meaning that Company X desired to have one individual, referred to as a “dealer principal”, to look to for distributor decisions. The new policy requires that a dealer principal own at least \geq % of the vote and value of the Corporation. The old policy had only required that the dealer principal hold \geq % of the vote of the Corporation not value.

To comply with this new policy, the Corporation will engage in the following transaction. Shareholder M will be named dealer principal. Shareholder M and Shareholder K will each purchase \underline{a} shares of the Corporation's Class B non-voting common stock from Shareholder D. Shareholder F will purchase from Shareholder A and Shareholder C their \underline{b} shares of the Corporation's Class A voting common stock. The Corporation will then purchase for cash, or for cash and the Corporation's promissory note, all of the outstanding shares of Class B non-voting stock owned by the following shareholders:

<u>Shareholder</u>	<u>Shares of Class B Non-Voting Common Stock Owned and Redeemed</u>
Shareholder A	\underline{c} shares
Shareholder B	\underline{d} shares
Shareholder C	\underline{e} shares
Shareholder D	\underline{f} shares
Shareholder E	\underline{g} shares
Shareholder H	\underline{h} shares
Shareholder I	\underline{i} shares
Shareholder J	\underline{j} shares
Shareholder O	\underline{k} shares
Shareholder P	\underline{l} shares
Shareholder Q	\underline{k} shares
Shareholder R	\underline{l} shares
Shareholder S	\underline{o} shares

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<u>Shareholder</u>	<u>Shares of Class B Non-Voting Common Stock Owned and Redeemed</u>
Shareholder T	<u>k</u> shares
Shareholder U	<u>l</u> shares

During the period Year B through Year A, Shareholder P, Shareholder R and Shareholder U received gifts of Class B Non-Voting Common Stock from Shareholder D and Shareholder E totaling x shares each. During the period Year B through Year C, Shareholder L and Shareholder N received gifts of Class B Non-Voting Common Stock from Shareholder D and Shareholder E totaling w shares each. In Year E, Shareholder M received y shares of Class A Voting Common Stock as a gift from Shareholder D and Shareholder E.

The taxpayers have made the following representations concerning the proposed transaction:

- (a) There are no outstanding options or warrants to purchase the Corporation's stock, nor are there any outstanding debentures or other obligations that are convertible into the Corporation's stock or would be considered the Corporation's stock.
- (b) Notes or other obligations of the Corporation may be distributed to one or more of the redeemed shareholders.
- (c) In no event will the last payment on any note or other obligation be made more than 15 years after the date of issuance of the note or other obligation.
- (d) The amount to be paid including interest, is a fixed amount payable at a fixed time, and the amount and the time of payment are not subject to any change or adjustment.
- (e) None of the consideration from the Corporation, including interest, consists entirely or partly of the Corporation's promise to pay an amount that is based on, or contingent on, future earnings of the Corporation, an amount that is contingent on working capital being maintained at a certain level, or any other similar contingency.
- (f) Any note or other obligation to be issued to a redeemed shareholder will not be subordinated to claims of general creditors of the Corporation.
- (g) In the event of default on any note or other obligation, no shares of stock

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will revert to or be received by a redeemed shareholder nor will any redeemed shareholder be permitted to purchase the stock at public or private sale.

- (h) No shareholder of the Corporation has been or will be obligated to purchase any of the stock to be redeemed.
- (i) The redemption described in this ruling request is not an isolated transaction. It is related to Shareholder F's purchase of all the voting stock owned by Shareholder A and Shareholder C, and to the purchases by Shareholder K and Shareholder M of a shares each of non-voting common stock from Shareholder D. The impact of this related transaction is that, coupled with the redemption, it fully divests Shareholder A, Shareholder C, Shareholder D and Shareholder E of any stock of the Corporation and it enables the three family members who are active in the business on an ongoing basis to have equal ownership in the non-voting equity of the Corporation.
- (j) The Corporation has had changes in its outstanding equity in the past five years. In Date A, each shareholder of voting preferred stock of the Corporation exchanged his or her voting preferred shares for a number of voting common shares such that before and after the exchange, the voting percentage owned by each exchanging shareholder was the same. More specifically, Shareholder A exchanged m shares of Class B Voting Preferred Stock (having a stated value of \$a per share) for n shares of Class A Voting Common Stock. Shareholder C exchanged p shares of Class B Voting Preferred Stock (having a stated value of \$a per share) for q shares of Class A Voting Common Stock. Shareholder K exchanged r shares of Class B Voting Preferred Stock (having a stated value of \$a per share) for s shares of Class A Voting Common Stock. Shareholder M exchanged t shares of Class B Voting Preferred Stock (having a stated value of \$a per share) for u shares of Class A Voting Common Stock. As a result of these exchanges, the Corporation has outstanding only one class of common stock, with differing voting privileges, so that, if the shareholders so elect, the Corporation may be treated as an S corporation beginning in Year D. In Year C, the Corporation purchased all the outstanding shares of its Class A Non-Voting Preferred Stock as either part of a § 303 redemption of stock to pay death taxes or as a purchase from shareholders who were beneficiaries of the estate.
- (k) Other than the proposed redemption and with the exception of additional shares that may be issued to Shareholder M in compliance with the Company X requirements regarding the "dealer principal," the Corporation has no plans or intention to issue, redeem, or exchange additional shares

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of stock.

- (l) There will be no distributions, redemptions, or issuances of the stock of any related corporation.
- (m) Other than the contemplated purchases (all described above) by Shareholder F, Shareholder K and Shareholder M and other than through gifts made by Shareholder D to his children in each of the years Year B through Year C, no redeemed shareholder or a related party has sold or acquired, or intends to sell or acquire, any stock of the Corporation or any related corporation either directly or constructively within five years of redemption (but Shareholder M may acquire additional shares within such five year period in connection with the requirements of Company X). The purchases by Shareholder F, Shareholder K and Shareholder M have been considered consummated for purposes of computing the ownership of stock after the redemption. The Corporation will not be liable, directly or indirectly, for any part of their obligations in the purchase of such stock.
- (n) The only relationship or transactions affecting a redeemed shareholder's percentage of ownership of any class of the Corporation's stock are the purchases, at fair market value, by Shareholder K and Shareholder M of certain shares of Class B Non-Voting Common Stock, and by Shareholder F of certain shares of Class A Voting Common Stock.
- (o) Although some of the stock to be redeemed was acquired by some redeemed shareholders within the 10-year period preceding the redemption from a person whose stock would be attributed under § 318(a) to such redeemed shareholders at the time of redemption, the acquisition did not have as one of its principal purposes the avoidance of federal income tax.
- (p) After the redemption, no redeemed shareholder will have any interest in the Corporation, including an interest as officer, director, or employee (other than an interest as a creditor as described in § 1.302-4(d) and constructive ownership under § 318(a)(1)).
- (q) Shareholder A, Shareholder B, Shareholder C, Shareholder D and Shareholder E will execute and file the agreement required by § 302(c)(2)(A)(iii) with respect to the acquisition of any interest in the Corporation within 10 years from the date of the redemption.
- (r) The only partnership, estate, trust or corporation that is a redeemed shareholder and has stock attributed to it under § 318(a)(3) from a "related person" is Shareholder B. The "related person" to Shareholder B

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is Shareholder F. None of the stock to be redeemed was acquired by Shareholder B within the 10-year period preceding the redemption from a person whose stock would be attributed under § 318(a) to Shareholder B at the time of redemption. Moreover, no person whose stock would be attributed to Shareholder B under § 318(a) will own stock of the Corporation after the redemption if the stock was acquired by that person from Shareholder B within 10-years preceding the redemption. After the redemption, Shareholder B will not have any interest in the Corporation including an interest as officer, director, or employee (other than an interest as a creditor as described in § 1.302-4(d) and constructive ownership under § 318(a)(1)). Shareholder B and each related person will agree to be jointly and severally liable for any deficiency (including interest and additional tax) resulting from an acquisition by Shareholder B of an interest in the Corporation within 10-years from the date of redemption.

- (s) None of the stock to be redeemed is “section 306 stock” within the meaning of § 306(c). The stock to be redeemed is common stock but it was not received in exchange for preferred stock.
- (t) There are no declared but unpaid dividends, or funds set apart for dividends, on any of the stock to be redeemed.
- (u) The redemption will be financed with notes of the Corporation (or from funds on hand or borrowed from a third party lender). The Corporation intends to borrow the funds necessary for the cash redemption from third party financial institutions, such as banks or insurance companies, none of whom will be related to the Corporation or its shareholders. In addition, the Corporation may utilize its ongoing unsecured line of credit from an unrelated banking institution to fund part of the cash purchase money obligation for the redemptions.
- (v) No party other than the Corporation will hold the stock to be redeemed.
- (w) No redeemed shareholder owes any amount to the Corporation.
- (x) At the time of the exchange, the fair market value of the consideration to be received by each redeemed shareholder will be approximately equal to the fair market value of the Corporation’s stock to be exchanged therefor.
- (y) The price to be paid for the Corporation’s stock to be redeemed will not result in a loss with respect to those shares of stock.
- (z) The proposed redemption will satisfy the definition of “installment sale” as

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defined in § 453(b). It is a disposition of property where at least one payment will be received after the close of the taxable year in which the disposition occurs. Moreover, the proposed redemption of the Corporation'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.

- (aa) The redeemed shareholders will receive from the Corporation either United States cash or notes or other obligations of the Corporation. The amount received by each redeemed shareholder will be the fair market value of each redeemed shareholder's shares as determined by independent appraisal. The amount received by each redeemed shareholder will be the fair market value of each redeemed shareholder's shares as determined by independent appraisal. The Corporation will not distribute any inventory or appreciated property to the redeemed shareholders. No liabilities of the Corporation will be assumed by a redeemed shareholder, and none of the property distributed will be subject to a liability. The Corporation will not distribute to a redeemed shareholder, as part of the redemption, any of the following: (1) any appreciated property, (2) any assets representing earned but unreported income or other assets resulting in an anticipatory assignment of income, (3) any installment obligation from a third party, (4) any property described in the recapture provisions of the Code, (5) any property for which the Corporation obtained a deduction, (6) any property described in § 1256 (Contracts Marked to Market) or § 1276 (Market Discount Bonds), or (7) any receivable. The redeemed shareholders have no plan or intention to sell, lease, or otherwise dispose of any notes received in the redemption.

Based solely on the information submitted and on the representations set forth above, we hereby rule as follows:

- (1) Section 318(a)(1) shall not apply in determining ownership of the Corporation's shares immediately after the redemptions to any redeemed shareholder who files the election required by § 302(c)(2)(A)(iii).
- (2) Each redemption shall be treated as a complete redemption of stock within the meaning of § 302(b)(3) for each redeemed shareholder.
- (3) Each redeemed shareholder shall be treated as having received in the

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redemption a distribution in part or full payment in exchange for the stock redeemed under § 302(a).

(4) Any gain recognized by each selling or redeeming shareholder shall be treated as gain from the sale of a capital asset as defined in § 1221.

(5) Shareholders receiving the Corporation's promissory note as consideration for the redemption of their shares may qualify to report the gain under the installment method under § 453.

(6) In determining whether or the extent to which a selling and/or redeeming shareholder has made a gift under applicable federal gift tax law, the fair market value of each selling and/or redeeming shareholder's shares will be determined with reference to the shares sold and/or redeemed by that shareholder and not with reference to the shares sold and/or redeemed in the aggregate by all shareholders. In determining whether or the extent to which a shareholder both selling shares and having shares redeemed in the transaction has made a gift under applicable federal gift tax law, the fair market value of each such shareholder's shares will be determined with reference to the shares sold and redeemed by that shareholder.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code 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 years in which the transaction covered by this letter is consummated.

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

Sincerely yours,

Debra Carlisle

Debra Carlisle
Branch Chief, Branch 5
Associate Chief Counsel (Corporate)

cc:

