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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:INTL:B04

PLR-164081-04

Date:

June 09, 2005

LEGEND

Target =

Foreign Acquirer =

Subsidiary =

Country A =

Date A =

Amount X =

Amount Y =

Amount X =

Business A =

Business B =

AA =
BB =
CC =
DD =
EE =
FF =
GG =

Dear :

This is in response to your letter, dated December 1, 2004, requesting a private letter ruling that an indirect transfer of stock in a domestic corporation (Target) under Treas. Reg. § 1.367(a)-3(d) in connection with a statutory merger described in §§ 368(a)(1)(A) and 368(a)(2)(E) (the Merger) will qualify for an exception to § 367(a)(1) of the Internal Revenue Code of 1986 (the Code). Additional information was submitted on May 17, 2005.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Target is a domestic corporation engaged in Business A. Before the Merger, Target stock was held privately by AA shareholders, BB of whom were U.S. persons as defined in § 7701(a)(30). Foreign Acquirer is a corporation organized under the laws of Country A. The stock of Foreign Acquirer is publicly traded on a stock exchange of Country A. Foreign Acquirer has no corporate income tax filing obligations with respect to the United States. Foreign Acquirer is engaged in Business B.

On Date A, Subsidiary, a wholly owned domestic subsidiary of Foreign Acquirer, merged with and into Target with Target surviving in a transaction represented to be a reorganization described in §§ 368(a)(1)(A) and 368(a)(2)(E) of the Code. Shareholders of Target received stock of Foreign Acquirer in exchange for their Target stock. No additional consideration was received by Target shareholders in exchange for their interests in Target.

The exchange of Target stock by the U.S. shareholders for stock of Foreign Acquirer that controlled Subsidiary (the merging corporation) in a reorganization described in §§ 368(a)(1)(A) and 368(a)(2)(E) is treated as an indirect transfer of Target stock to a foreign person under § 367(a). See Treas. Reg. § 1.367(a)-3(d)(1)(i). In the case of an indirect transfer of domestic stock by a U.S. person to a foreign corporation, the U.S. transferor will qualify for nonrecognition treatment under § 354 only if the requirements of Treas. Reg. § 1.367(a)-3(c)(1) are satisfied.

Among the requirements of Treas. Reg. § 1.367(a)-3(c)(1) is the requirement that the U.S. target company must satisfy the reporting requirements of Treas. Reg. § 1.367(a)-3(c)(6). Target represents that it will satisfy the reporting requirements of Treas. Reg. § 1.367(a)-3(c)(6).

Another requirement is that each U.S. transferor who is a 5% shareholder of the transferee foreign corporation immediately after the exchange must enter into a five-year gain recognition agreement as provided in Treas. Reg. § 1.367(a)-8. Foreign Acquirer and Target represent that all such 5% shareholders of Foreign Acquirer will enter into a five-year gain recognition agreement as provided in Treas. Reg. § 1.367(a)-8 with respect to the Target stock exchanged.

An additional requirement is that U.S. persons transferring U.S. target stock must receive, in the aggregate, 50% or less of both the total voting power and total value of the stock in the transferee foreign corporation (taking into account the attribution rules of § 318 of the Code, as modified by the rules of § 958(b) of the Code). Target and Foreign Acquirer represent that of the CC shares of Foreign Acquirer outstanding immediately after the exchange, the U.S. shareholders of Target received DD shares, which constituted 50% or less of both the total voting power and total value of Foreign Acquirer.

A further requirement of Treas. Reg. § 1.367(a)-3(c)(1) is that U.S. persons who are officers or directors of the U.S. target corporation, or who are 5% shareholders (by vote or value) of the U.S. target corporation, must own in the aggregate immediately after the transfer, 50% or less of each of the total voting power and the total value of the stock in the transferee foreign corporation (taking into account the attribution rules of § 318 of the Code, as modified by the rules of § 958(b) of the Code). Target represents that U.S. persons who are officers, directors, or 5% Target shareholders will own in the aggregate, actually or constructively, 50% or less of each of the total voting power and value of all shares of Foreign Acquirer outstanding immediately after the Merger.

Among the remaining requirements of Treas. Reg. § 1.367(a)-3(c)(1) is that the active trade or business test of Treas. Reg. § 1.367(a)-3(c)(3) must be satisfied. The active trade or business test consists of three elements. The first element provides that the transferee foreign corporation (or any qualified subsidiary or qualified partnership as defined under Treas. Reg. § 1.367(a)-3(c)(5)(vii) and (viii)) must have been engaged in the active conduct of a trade or business outside the United States, within the meaning

of Treas. Reg. § 1.367(a)-2T(b)(2) and (3), for the entire 36-month period immediately preceding the exchange of U.S. target stock. Foreign Acquirer and Target represent that Foreign Acquirer and its qualified subsidiaries have been continuously engaged in Business B for the entire 36-month period preceding the Merger.

The second element of the active trade or business test provides that at the time of the exchange, neither the transferors nor the transferee foreign corporation (or any qualified subsidiary or qualified partnership engaged in the active trade or business) will have the intention to substantially dispose of or discontinue such trade or business. Foreign Acquirer and Target represent that neither Target shareholders nor Foreign Acquirer will have an intention to substantially dispose or discontinue Foreign Acquirer's active trade or business.

The third element of the active trade or business test is the substantiality test as defined in Treas. Reg. § 1.367(a)-3(c)(3)(iii). Under the substantiality test, the transferee foreign corporation must be equal or greater in value than the U.S. target corporation at the time of the U.S. target stock exchange (see Treas. Reg. § 1.367(a)-3(c)(3)(iii)(A)). Target is a privately owned corporation, so trading values are not available. However, under the facts of this case, an appropriate indicator of Target's value for purposes of the substantiality test is the value ascribed to Target by the parties pursuant to the Merger agreement. In this case, the value of Target can be determined by the amount of Foreign Acquirer stock received by all of the Target shareholders. After the Merger, the Target shareholders held EE shares of stock of Foreign Acquirer by virtue of receiving such shares in exchange for their Target Stock in the Merger. This represented less than half the number of shares of Foreign Acquirer stock, taking into account certain longstanding options to acquire FF shares of Foreign Acquirer. These options were deeply discounted, were not held directly or indirectly by Target shareholders, and were anticipated at the time of the Merger to be exercised by the holders. Those options were in fact exercised shortly after the Merger. Including those options as exercised, Foreign Acquirer has GG shares outstanding (without these there were CC shares outstanding).

Pursuant to Treas. Reg. § 1.367(a)-3(c)(3)(iii)(B)(1), the value of the transferee foreign corporation is reduced for purposes of the substantiality test by the amount of any asset acquired outside the ordinary course of business by such corporation or any of its qualified subsidiaries or qualified partnerships within the 36-month period preceding the exchange to the extent that (i) at the time of the exchange such asset produces or is held for the production of passive income, as defined in § 1297(b) or (ii) such asset was acquired for the principal purposes of satisfying the substantiality test (commonly referred to as the "stuffing rule"). In addition, pursuant to Treas. Reg. § 1.367(a)-3(c)(3)(iii)(B)(3) the value of the transferee foreign corporation is reduced by the value of assets received within the 36-month period prior to the acquisition if such assets were owned by the U.S. target company or an affiliate. Foreign Acquirer within the 36-month period preceding the exchange had sought new financing on a regular basis to fund its business activities. Foreign Acquirer represents that assets acquired

outside the ordinary course of Foreign Acquirer's business within the 36-month period preceding the exchange were acquired in transactions which were not undertaken for the purpose of satisfying the substantially test of Treas. Reg. § 1.367(a)-3(c)(3)(iii). During the 36-month period preceding the exchange, Foreign Acquirer acquired total fixed assets of approximately Amount X, with approximately Amount Y of such additions composed of computer equipment and the balance composed of leasehold improvements and office fixtures, fitting and equipment. These assets neither produce nor are held for the productions of passive income as defined in § 1297(b).

Under Treas. Reg. § 1.367(a)-3(c)(9), the Service may, in limited circumstances, issue a private letter ruling to permit a taxpayer to qualify for an exception to § 367(a)(1) if a taxpayer is unable to satisfy all of the requirements of the active trade or business test, but is in substantial compliance with such test and meets all of the other requirements of Treas. Reg. § 1.367(a)-3(c)(1).

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

- 1) The transfer of Target shares by U.S. persons for shares of Foreign Acquirer will qualify for an exception to § 367(a)(1) under Treas. Reg. §§ 1.367(a)-3(c)(1) and 1.367(a)-3(c)(9).
- 2) Any U.S. person transferring Target shares who is a 5% transferee shareholder (as defined in Treas. Reg. § 1.367(a)-3(c)(5)(ii)) will qualify for the exception to § 367(a)(1) only upon entering into a five-year gain recognition agreement pursuant to Treas. Reg. § 1.367(a)-8.

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. In particular, no opinion is expressed as to whether the Merger qualified as a reorganization within the meaning of §§ 368(a)(1)(A) and 368(a)(2)(E) of the Code. In addition, no opinion is expressed as to the reporting requirements of U.S. persons exchanging stock under § 6038B and the regulations thereunder.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/s/ Robert W. Lorence, Jr.

Robert W. Lorence, Jr.
Senior Counsel, Branch 4
Office of Associate Chief Counsel (International)

cc: