

Internal Revenue Service

Department of the Treasury

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CC:CORP:B02-PLR-118079-01

Date:

December 19, 2001

LEGEND:

Company =

State X =

Business Y =

Business Z =

Market =

b% =

c =

d% =

e =

Date F =

Exchanging Shareholder A =

Exchanging Shareholder B =

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Exchanging Shareholder C =

This letter responds to your authorized representative's letter dated March 23, 2001, in which you requested rulings under sections 108, 305, 306, and 368 of the Internal Revenue Code. Additional information was submitted in letters dated May 23, November 26, and December 6, 2001. The material information submitted for consideration is summarized below.

Company is a State X corporation engaged in Business Y and Business Z. Company has a calendar year end and uses the accrual method of accounting. The outstanding stock of Company consists of voting common stock, Series A b% convertible preferred stock ("Series A Stock"), and two other classes of preferred stock, Series B and Series C, not relevant here. Company also has outstanding Series B warrants (the "Warrants") to acquire Company common stock. The Warrants have an exercise price of c per share.

Company's common stock is traded on the Market. The common stock is not convertible and is not entitled to a preference on earnings or liquidation proceeds. The common stock may be redeemed but there is no set price for such redemption.

Exchanging Shareholder A, Exchanging Shareholder B, and Exchanging Shareholder C own all of the Series A Stock. As an accommodation to Exchanging Shareholder C, Company issued the Series A Stock in exchange for Exchanging Shareholder C's one-year, 9.25% promissory note (the "Note"). The Note was repaid on Date F in connection with the consummation of an unrelated transaction.

The Series A Stock is entitled to 4 votes per share when voting as part of the class of common stock and is also entitled to vote separately as a class of preferred stock and as a series of Series A Preferred Stock as provided by State X law. The Series A stock pays a preferential dividend (along with certain dividends payable on other preferred stock) and has a liquidation preference. The Series A Stock does not have dividends in arrears.

To reduce annual dividend payments on the Series A Stock, Company has proposed and partially consummated the following transactions:

- (i) Company's Board authorized a new Series D convertible preferred stock ("Series D Stock"). The Series D Stock will have rights and par value substantially identical to those of the Series A preferred stock except that it will pay a d% preferential dividend and there will be implemented a dividend protection fund (the "Dividend Protection Fund") which will provide a purely contingent benefit to assure payment of dividends.

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- (ii) The Series A Stock held by Exchanging Shareholder A, Exchanging Shareholder B, and Exchanging Shareholder C will be exchanged for an equal number of shares of Series D Stock, together with e Warrants (the "Exchange").
- (iii) The purchase price paid by Exchanging Shareholder C for its shares of Series A Stock (and the principal amount of the Note) will be reduced as a retroactive purchase price adjustment.

Section 3.01(29) of *Rev. Proc. 2001-3, 2001-1 I.R.B. 111, 114*, states that the Service will not rule on whether a transaction qualifies under section 368(a)(1)(E) for nonrecognition treatment and whether various consequences result from the application of that section, unless the Service determines that there is a significant issue that must be resolved in order to decide those matters. If there is a significant issue, the Service will rule on an entire transaction. You have requested rulings as to whether the transactions described qualify for nonrecognition treatment under section 368(a)(1)(E) when preferred stock is exchanged for preferred stock with a reduced dividend and warrants.

The following representations have been made in connection with the proposed transactions:

- (a) Company and its Exchanging Shareholders will each pay their own expenses, if any, incurred in connection with the Exchange.
- (b) None of Company's outstanding stock is "section 306 stock" within the meaning of section 306.
- (c) The fair market value of the Series D Stock and Warrants received by each Exchanging Shareholder in the Exchange will approximately equal the fair market value of the Series A Stock surrendered.
- (d) The corporate business purpose for the Exchange is to reduce the annual dividend payments by Company on its outstanding preferred stock.
- (e) Company has no plan or intention to redeem or otherwise reacquire any shares of the Series D Stock issued in the transaction.
- (f) The Exchanging shareholders do not have any plan or intention to dispose of any of the Series D Stock or Warrants received by them in the Exchange.
- (g) Company will continue to conduct its business operations after the proposed transactions.

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- (h) The proposed transaction is an isolated transaction and is not part of a plan periodically to increase the proportionate interest of any shareholder in the assets or earnings and profits of Company.
- (i) Company is not under the jurisdiction of a court in a title 11 or similar case within the meaning of section 368(a)(3)(A).
- (j) Neither the Series A preferred stock nor the Series D preferred stock are non-qualified preferred stock within the meaning of section 351(g).
- (k) Although Company has the right to redeem the Series D Stock to be issued in the Exchange, based upon all the facts and circumstances, redemption pursuant to that right is not more likely than not to occur.
- (l) The Dividend Protection Fund does not materially increase the likelihood that Company will exercise its right to redeem the Series D Stock to be issued in the Exchange.

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

- (1) The Exchange will qualify as a reorganization under section 368(a)(1)(E). Company will be “a party to a reorganization” under section 368(b).
- (2) No gain or loss will be recognized by Company on receiving the Series A Stock from an Exchanging Shareholder in the Exchange (section 1032(a)).
- (3) No gain or loss will be recognized by an Exchanging Shareholder on receiving the Series D Stock and the Warrants in the Exchange (sections 354(a)(1) and 356(a)).
- (4) The basis of the Series D Stock received by an Exchanging Shareholder will equal the basis of the Series A Stock surrendered in the Exchange (section 358(a)(1)).
- (5) The holding period of the Series D Stock received by an Exchanging Shareholder will include the period during which the Series A Stock surrendered in the Exchange was held, provided the Series A Stock surrendered was held as a capital asset on the date of the Exchange (section 1223(1)).
- (6) The Exchange will not be treated as a distribution of property to which section 301 applies by reason of the application of section 305(b) and section 305(c).

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- (7) The Series D Stock received by an Exchanging Shareholder in the Exchange will not be "section 306" stock as that term is defined in section 306(c).
- (8) The Warrants received by an Exchanging Shareholder in the Exchange (and the common stock acquired through exercise of the Warrants) will not be "section 306" stock as that term is defined in section 306(c).

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, we express no opinion as to whether the purported retroactive purchase price adjustment as described in step (iii) above results in cancellation of indebtedness income.

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 representative.

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

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.

Sincerely,
Charles M. Levy
Reviewer, Branch 2
Office of Office of Associate Chief Counsel
(Corporate)