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Acquiring =

Acquiring Subsidiary =

Target =

State A =

State B =

State C =

Business =

X =

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This letter is in response to the request, dated February 3, 1998, for rulings pursuant to section 368(a)(1)(C) of the Internal Revenue Code on behalf of the above-captioned taxpayers. Additional information with respect to the proposed transaction was submitted in letters dated November 3 and 10, 1998, and January 7 and 8, 1999. The information submitted for our consideration is summarized as follows.

Target is a State A corporation that is engaged in Business. Target is also authorized to operate under the laws of State B. Target uses the accrual method of accounting and files its tax returns on a calendar basis. Target has two classes of voting stock, Class A and Class B, that are issued and outstanding. The Target stock is widely held but it is not publicly traded.

Acquiring is a State B corporation which is authorized to operate in State A. The stock of Acquiring is widely held and publicly traded. Acquiring is an accrual method taxpayer and it files its returns on a fiscal year ending September 30. Acquiring Subsidiary, a wholly-owned subsidiary of Acquiring, is also engaged in Business and operates under the laws of State C. Acquiring Subsidiary uses the accrual method of accounting

Target and Acquiring are opposing litigants in a civil action in which Acquiring is attempting to recover damages from Target in connection with an operation conducted by Target. In settlement of this cause of action, both parties have entered into a Purchase and Reorganization Agreement, pursuant to which substantially all of the assets of Target will be transferred to Acquiring Subsidiary solely in exchange for shares of Acquiring voting stock. Certain nominal assets will be retained by Target to be sold, the proceeds of which will be used solely to pay any outstanding Target liabilities at the date of the transaction. Any cash remaining after the payment of these liabilities will be transferred to Acquiring Subsidiary as part of the transaction.

The parties have entered into a Pre-Closing Escrow Agreement whereby, prior to the proposed transaction and as part of the settlement, Target has put and will continue to put 50 percent of its Business operating revenues into an escrow for distribution to Acquiring upon consummation of the proposed transaction.

Following the transfer of the Acquiring stock to Target, Target presently anticipates that it will be able to transfer only approximately X percent of the stock received to its shareholders because the shareholders owning the balance of the outstanding Target stock may not have been located. Pursuant to a State A Court Order, the shares of the voting stock of Acquiring attributable to unlocated Target shareholders will be held by a Guardian Ad Litem who will conduct searches and publish notices of the transaction. After 12 months from the date of the transaction, the Acquiring shares attributable to the then unlocated shareholders will be allocated among the known Target shareholders pursuant to a final State A Court

Order.

Target and Acquiring have also entered into a Post-Closing Escrow Agreement to secure Target's indemnification obligation in the proposed transaction. Under the Escrow Agreement, Acquiring stock with a value of \$500,000 will be delivered to the Escrow Agent to be held for a 12-month period following the transaction. During this period dividends and voting rights on the escrowed shares will be in the known Target shareholders. To the extent unlocated shareholders are located the shares held in escrow will be reissued in their names and they also will be entitled to the dividends and voting rights on the escrowed stock.

The following representations have been made by Target and Acquiring with respect to the proposed transaction:

- (a) The fair market value of Acquiring stock received by each Target shareholder will be approximately equal to the fair market value of the Target stock surrendered in the exchange.
- (b) There is no plan or intention by Acquiring or Acquiring Subsidiary or any person (as defined in Section 1.368-1(e)(3)) related to either Acquiring or Acquiring Subsidiary to acquire or redeem any of the Acquiring stock issued in the proposed transaction either directly or through any transaction, agreement or arrangement with any other person.
- (c) During the five-year period ending on the date of the proposed transaction neither Target nor any person related to Target (as defined in Section 1.368-1(c)(3) without any regard to Section 1.368-1(e)(3)(A)) will have directly or through any transaction, agreement or arrangement with any other person, (a) acquired stock of Target with consideration other than shares of Acquiring or Target stock (except for shares of Target stock acquired by Target from dissenters in the transaction); or (b) redeemed or made distribution with respect to Target stock.
- (d) Prior to the transaction neither Acquiring, Acquiring Subsidiary nor any person (as defined in Section 1.368-1(e)(3)(A)) related to Acquiring or Acquiring Subsidiary will have acquired directly or through any transaction, agreement or arrangement with any other person, stock of Target with consideration other than shares of Acquiring stock.

- (e) Acquiring Subsidiary will acquire at least 90 percent of the fair market value of the net assets and at least seventy percent of the fair market value of the gross assets held by Target immediately prior to the transaction. For purposes of this representation, amounts paid by Target shareholders who receive cash or other property, and all redemptions and distributions (except for regular, normal dividends) made by Target immediately preceding the transfer will be included as assets of Target held immediately prior to the transaction.
- (f) Acquiring has no plan or intention to reacquire any of the Acquiring stock issued in the transaction.
- (g) Acquiring Subsidiary has no plan or intention to sell or otherwise dispose of the assets of Target acquired in the transaction, except for dispositions made in the ordinary course of business or transfers described in § 368(a)(2)(C).
- (h) Target will distribute the stock, securities and other property it receives in the transaction, in pursuance of the plan of reorganization.
- (i) Acquiring Subsidiary is not assuming any liabilities of Target and none of the assets being acquired by Acquiring Subsidiary are subject to any liability.
- (j) Following the transaction, Acquiring Subsidiary will continue the historic business of Target or use a significant portion of Target's historic business assets in a business.
- (k) Acquiring Subsidiary, Target and the shareholders of Target will pay their respective expenses, if any, incurred in connection with the transaction.
- (l) There is no inter-corporate indebtedness existing between Acquiring Subsidiary and Target that was issued, acquired or will be settled at a discount.
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) Target is not under the jurisdiction of a court in a title 11 or similar

case within the meaning of § 368(a)(3)(A).

With respect to the Post-Closing Escrow Agreement, the following representations have been made:

- (o) All of the stock to be issued in the reorganization will be issued within five years from the date of the transfer of Target's assets to Acquiring Subsidiary for Acquiring stock.
- (p) There is a valid business reason for not issuing all of the stock at the time of the reorganization, that is, to secure Target's indemnification obligation to Acquiring Subsidiary.
- (q) The maximum number of shares to be issued to Target shareholders is established by the purchase price formula.
- (r) At least fifty percent of the maximum number of shares of each class of stock that may eventually be issued will be issued at the time of the transfer of Target's assets to Acquiring Subsidiary.
- (s) The triggering event for the release of shares from escrow or the issuance of additional shares is not an event the occurrence or nonoccurrence of which is within the control of Target's shareholders and is not based on the determination of a federal income tax liability related to the reorganization.
- (t) The formula for calculating the number of Acquiring shares to be released from the escrow is objective and readily ascertainable.
- (u) With respect to the escrow arrangements, any escrowed Acquiring stock will be legally outstanding and shown as such on Acquiring's shareholder records and financial statements. To the extent that the former Target shareholders are identified and known at the date of the closing of the transaction in issue, the dividends and voting rights on their respective shares will rest with the former Target shareholders. The escrowed shares will not be subject to restrictions that require their return to Acquiring Subsidiary and/or Acquiring because of death, retirement or similar events with respect to former Target shareholders.

Based solely on the information and representations submitted, we rule as follows:

- (1) The acquisition by Acquiring Subsidiary of substantially all of the assets of Target in exchange solely for Acquiring voting common stock, as described above, will qualify as a tax-free reorganization under § 368(a)(1)(C).
- (2) Acquiring, Acquiring Subsidiary and Target will each be “a party to a reorganization” within the meaning of § 368(b).
- (3) No gain or loss will be recognized by the shareholders of Target upon the receipt of Acquiring common stock in exchange for their Target stock under § 354(a)(1) .
- (4) The basis of the shares of Acquiring voting common stock received by the Target shareholders in exchange for their Target voting stock will be the same as the basis of the Target voting stock surrendered in exchange therefor under § 358(a)(1).
- (5) No gain or loss will be recognized by Target by reason of its transfer of substantially all of its assets to Acquiring Subsidiary in exchange for Acquiring voting common stock pursuant to § 361(a).
- (6) No gain or loss will be recognized by Acquiring or Acquiring Subsidiary upon Acquiring Subsidiary’s receipt of substantially all of the assets of Target in exchange for shares of Acquiring voting common stock under § 1032.
- (7) The basis of the assets of Target in the hands of Acquiring Subsidiary will be, in each instance, the same as the basis of those assets in the hands of Target immediately prior to the proposed transaction in accord with § 362(b).
- (8) The holding period of Target’s assets in the hands of Acquiring Subsidiary will include the period during which the assets were held by Target as provided in § 1223(2).
- (9) The holding period of the Acquiring voting stock received by the Target shareholders will include the holding period during which the Target common stock surrendered in exchange therefor was held, provided that such stock is held as a capital asset in the hands of the Target shareholders on the date of the exchange under § 1223(1).

- (10) The issuance of Acquiring stock by Acquiring Subsidiary in exchange for substantially all the assets of Target will not result in gain or loss recognition to Acquiring or Acquiring Subsidiary under § 361(c).

No opinion is expressed about the federal income tax treatment of the proposed transaction under other provisions of the Code and regulations or about 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. In particular, opinion is reserved as to the federal income tax treatment to the located shareholders of Target of the distribution of any additional shares of Acquiring stock, attributable to unlocated Target shareholders by reason of a State A Court Order or otherwise. A determination of the appropriate tax treatment to these Target shareholders will be made by the appropriate District Directors' office upon audit of the federal income tax returns in which the proposed transaction is reported.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Each affected taxpayer should attach a copy of this letter to the federal income tax return for the taxable year in which the proposed transaction covered by this ruling letter is consummated.

In accordance with the powers of attorney on file in this office, we have sent copies of this letter to the authorized representatives.

Sincerely Yours,

Assistant Chief Counsel
(Corporate)

By: _____
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Branch 1