

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:FIP:2-PLR-128794-02
Date:
September 19, 2002

Legend

Parent =
New Parent =
LLC 1 =
LLC 2 =
Business A =
Business B =

Business C =
State A =
X =
Y =
Maturity 1 =
Maturity 2 =
Act =

Dear :

This is in response to a letter dated May 22, 2002, and subsequent correspondence, requesting rulings that a corporate restructuring of the taxpayer's business will not result in a deemed exchange of debt pursuant to section 1001 of the Internal Revenue Code.

FACTS

Parent is a State A publicly traded corporation and the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Parent, directly and through its subsidiaries engages in Businesses A, B, and C both within the United States and internationally.

Parent has outstanding, publicly traded debt consisting of four series of senior notes and four series of exchangeable debentures (collectively referred to as the "Debt"). The senior notes have an aggregate principal amount of approximately X, pay a market rate of interest semi-annually, and mature variously within Maturity 1. The exchangeable debentures have an aggregate principal amount of approximately Y, pay a market rate of interest semi-annually, and mature variously within Maturity 2. The debentures are exchangeable by the holders at any time for the cash value of a specified number of shares of portfolio stock in one of three other companies. In certain instances, Parent may satisfy the exercise of a holder's exchange right by paying the exchange value in cash, shares of the referenced portfolio stock or a combination thereof. The current trading price of one or more series of the Debt is substantially less than its respective adjusted issue prices. The Debt is recourse to Parent, and none of its assets is subject to any perfected or unperfected security interest benefitting any of the holders of any series of the Debt. There are no provisions in the terms of the Debt that restrict Parent's ability to acquire and dispose of assets in the normal course of its business.

Parent proposes to restructure its corporate group in order to realign its internal structure along geographic lines. In the first phase of the restructuring, a newly-formed wholly-owned State A subsidiary of a newly-formed State A holding corporation (New Parent) will merge with and into Parent, with Parent surviving as the wholly-owned subsidiary of New Parent. Parent will then convert into a single-member State A limited liability company (LLC 1) by filing a certificate of conversion under the Act. The first phase of the restructuring is intended to qualify as a reorganization pursuant to section 368(a) of the Code. The conversion of Parent into LLC 1 will not involve the formation or merger of Parent with or into a new legal entity.

In the second phase of the restructuring, LLC 1 will form a second State A single-member limited liability company (LLC 2). Following a series of intragroup distributions and contributions of the stock of various subsidiaries, LLC 1 will distribute its interest in LLC 2 to New Parent. After the restructuring, New Parent will hold all of the membership interests in LLC 1 and LLC 2, two limited liability companies that will be disregarded as separate from their owner under section 301.7701-3(b)(1)(ii) of the procedural regulations. LLC 1 will hold the stock of subsidiaries engaged primarily in business within the United States and LLC 2 will hold the stock of subsidiaries engaged primarily in business internationally.

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Pursuant to the Act, LLC 1 will remain the same legal entity as Parent. None of the Debt holders' rights against Parent, including with respect to payments and remedies, and none of Parent's obligations and covenants to the Debt holders will be altered in any manner by the restructuring. Following the restructuring, the Debt holders will continue to have exactly the same legal relationship with LLC 1 that they previously had with Parent, *viz.*, as general unsecured recourse claimants having no greater preference than any other creditor. Additionally, under State A law, the restructuring will not result in the creation of any legal rights or obligations between the Debt holders and New Parent. There are no provisions in the original terms of the Debt that require the consent or approval of any Debt holders for Parent to effectuate the restructuring.

LAW AND ANALYSIS

Section 1001 provides for the recognition of gain or loss on the sale or exchange of property. Section 1.1001-1(a) of the regulations provides that gain or loss is realized from the exchange of property for other property differing materially either in kind or in extent.

Section 1.1001-3(b) provides that a debt instrument differs materially in kind or in extent if it has undergone a "significant modification." A significant modification of a debt instrument results in a "new" debt instrument that is deemed to be exchanged for the unmodified debt instrument.

Section 1.1001-3(c) provides rules for determining whether a change in the legal rights or obligations of a debt instrument is a modification. Pursuant to § 1.1001-3(c)(1)(i), a modification means any alteration, including any deletion or addition, in whole or in part, of a legal right or obligation of the issuer or a holder of a debt instrument, whether the alteration is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise.

Section 1.1001-3(c)(1)(ii) provides that, except as provided in paragraph (c)(2), an alteration of a legal right or obligation that occurs by operation of the terms of a debt instrument is not a modification.

Section 1.1001-3(c)(2)(i) provides that an alteration that results in the substitution of a new obligor, the addition or deletion of a co-obligor, or a change (in whole or in part) in the recourse nature of the debt instrument (from recourse to nonrecourse or from nonrecourse to recourse) is a modification, even if the alteration occurs by operation of the terms of a debt instrument.

Section 1.1001-3(e) provides rules for determining whether a modification is significant. Section 1.1001-3(e)(4) provides that with certain exceptions, the substitution of a new obligor on a recourse debt instrument is a significant modification.

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Section 18-214(e) of the Act provides that for State A law purposes, the conversion of any other entity into a domestic limited liability company shall not be deemed to affect any obligations or liabilities of the other entity incurred prior to its conversion to a domestic limited liability company or the personal liability of any person incurred prior to such conversion. Moreover, section 18-214(f) of the Act provides, inter alia, that for all purposes of State A law, all rights of creditors and all liens upon any property of the other entity that has converted shall be preserved unimpaired, and all debts, liabilities and duties of the other entity that has converted shall thenceforth attach to the domestic limited liability company and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it.

Generally, the federal tax law looks to State law to determine legal entitlements in property. Aquilino v. United States, 363 U.S. 509, 513 (1960); Morgan v. Commissioner, 309 U.S. 78, 82 (1940). The legal rights or obligations referred to in section 1.1001-3(c) are rights that are determined under State law. Pursuant to the Act, the conversion of Parent into LLC 1 will not affect the legal rights or obligations between the Debt holders and Parent because, as a matter of State law, LLC 1 will remain the same legal entity as Parent. The Debt holders will continue to have exactly the same legal relationship with LLC 1 that they previously had with Parent, viz., as general unsecured recourse claimants having no greater preference than any other creditor.

The Debt holders' legal rights against LLC 1 with respect to payments and remedies will be the same legal rights that the Debt holders had against Parent. The obligations and covenants from LLC 1 to the Debt holders will be the same as the obligations and covenants from Parent to the Debt holders. Since the Act specifically provides for the retention of the legal rights and obligations between Parent (in the form of LLC 1) and the Debt holders, and since there were no legal rights or obligations between the Debt holders and New Parent prior to the restructuring, the restructuring cannot result in the creation of any new legal rights or obligations between the Debt holders and New Parent.

In these circumstances, the restructuring will not effect an alteration that results in either a change of obligor or a change in the recourse nature of the Debt for purposes of section 1.1001-3(c)(2)(i).

CONCLUSION

Based on the facts and representations of the taxpayer, we conclude that:

Neither the conversion of Parent into LLC 1 in the first phase of the restructuring, nor the distribution of assets by LLC 1 in the second phase of the restructuring results in a modification of the Debt for purposes of section 1.1001-3 of the regulations.

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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.

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.

Sincerely,
William E. Coppersmith
William E. Coppersmith
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)