

## Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

**February 5, 2003**

### Legend

Company =

State A =

Business B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

a =

b =

c =

d =

e =

Dear \_\_\_\_\_ :

This letter responds to a letter dated September 30, 2002 requesting rulings on the federal income tax consequences of a proposed transaction. The facts and representations submitted in that request are summarized below.

Company, a State A corporation, is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year basis. Company is engaged in Business B. The Company has issued and outstanding common stock and several classes of preferred stock. All outstanding stock of Company is owned exclusively by active employees of the Company and its affiliates. Company periodically gives key employees of the Company and its affiliates the opportunity to purchase common stock of Company.

Under the terms of Company's bylaws, a stockholder is required to sell his shares back to Company upon the stockholder's death, retirement, or termination of employment with the Company or its affiliates. The price at which the common stock must be sold to Company is determined under the valuation formula set forth in the bylaws. All classes of the preferred stock must be sold back to Company for an amount equal to the stock's redemption price. No shares of common stock or preferred stock may be transferred or encumbered except pursuant to the bylaws.

Company plans to offer certain key employees ("Principals") the right to purchase common stock of the Company. Company proposes to distribute a new class of preferred stock ("New Preferred") to its common stockholders in order to reduce the value of the common stock and thereby make the proposed stock offering more attractive to the new Principals. Company proposes that between Date 2 and Date 4, it will declare and distribute a dividend of a shares of newly authorized New Preferred stock on each share of its common stock outstanding.

The New Preferred stock will have a par value of \$b per share and a redemption price and liquidation preference of \$c per share plus dividends accumulated or declared and unpaid thereon for preceding years. Additionally, the New Preferred stock will be entitled to an annual cumulative dividend of \$d per share and to an additional non-cumulative dividend of \$e per share. The Company's common stock will be subordinate in all respects to all other classes of Company's preferred stock, including the New Preferred stock. The New Preferred stock will not be convertible preferred stock and will be subordinate in all respects to all other classes of Company preferred stock.

Company will select new Principals on Date 3. At the time these new Principals are chosen, each of them will be entitled to purchase shares of the Company's common stock. The price at which the new Principals may purchase the common stock will be

calculated by reference to the book value of the common stock as of Date 1, appropriately adjusted for the subsequent issuance of the New Preferred stock. This value will not be determined until Company's official audit is completed by Date 3. The new Principals will receive letters officially entitling them to purchase the common stock and informing them of the terms after the audit is completed and after the New Preferred stock distribution has been declared and made. The new Principals may not purchase the common stock pursuant to their rights as Principals until the New Preferred stock has been issued. The new Principals will not be entitled to share in the New Preferred stock distribution.

Company has made the following representations in connection with the proposed transaction:

(a) Company and its stockholders will each pay his, her or its own expenses, if any, incurred in connection with the proposed transaction, with the exception of the taxes paid in a loan program for certain shareholders.

(b) Company does not have any outstanding warrants, options, convertible securities, or any type of right under which any person could acquire stock in Company, except that the new Principals will have the right to purchase common stock (after the proposed distribution of New Preferred stock) at the common stock's value per share as determined under the bylaws after giving effect to the distribution of New Preferred stock.

(c) Company has no intention to redeem any New Preferred stock except as provided in the bylaws in the event of death, retirement, or termination of employment of a stockholder.

(d) Except in accordance with the bylaws, which require the sale to Company of all of a stockholder's shares of Company's stock upon the retirement, termination of employment, or death of the stockholder, the common stockholders have no plan or intention to sell or otherwise dispose of any of the New Preferred stock to be received by them in the proposed transaction.

(e) The New Preferred stock is redeemable at any time by Company, but is not redeemable at the option of a stockholder.

(f) The stockholders of Company will not have an election to receive any stock, cash, or property other than shares of New Preferred stock.

(g) The fair market value of the New Preferred stock at the time of issuance will be at least equal to the redemption price of such stock.

Based solely on the information provided and the representations set forth

above, it is held as follows:

(1) Pursuant to section 305(a) of the Internal Revenue Code, the proposed distribution by Company of New Preferred stock with respect to its common stock will not result in gross income to its common stockholders.

(2) No gain or loss will be recognized by Company upon the distribution of New Preferred stock, as described above. Section 311(a).

(3) Pursuant to section 307(a), the cost or other basis of Company's common stock held immediately prior to the distribution of New Preferred stock will be allocated in accordance with section 1.307-1(a) of the Treasury Regulations between the common stock held prior to the distribution and the New Preferred stock, in proportion to the fair market value of the common stock and the New Preferred stock on the date of distribution.

(4) The holding period of the New Preferred stock to be received by Company's stockholders will include the periods during which the common stock was held by each stockholder before receipt of the preferred stock distribution. Section 1223(5).

(5) The New Preferred stock received by Company shareholders will be "section 306 stock" within the meaning of section 306(c) of the Code to the extent that a distribution of money, in lieu of stock, would have been a dividend at the time of the distribution.

No opinion is expressed, and none was requested, as to the federal income tax consequences resulting from the payment of taxes in a loan program for certain shareholders. No opinion is expressed, and none was requested, as to the federal income tax consequences resulting from the granting of rights to certain employees of Company to purchase Company common stock. No opinion is expressed, and none was requested, as to the federal income tax consequences resulting from the redemption or acquisition of any Company stock pursuant to Company by-laws, as described above.

Additionally, no opinion is expressed as to the tax treatment of the transaction under the provisions of any other sections of the Code and the regulations which may be applicable thereto or the tax treatment of any conditions existing at the time of, or effects resulting from the transaction, which are not specifically set forth in the above ruling.

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.

A copy of this letter should be attached to the federal income tax return of the taxpayer involved for the taxable year in which the transaction covered by this letter is consummated.

Sincerely,

Lisa A. Fuller  
Assistant Branch Chief, Branch 1  
Office of Chief Counsel (Corporate)