

Internal Revenue Service

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Washington, DC 20224

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Date:

June 07, 2004

LEGEND

Corporation 1 =

Corporation 2 =

State X =

Business A =

Business B =

Preferred =

Corporation 1 Common =

Corporation 2 Common =

u =

v =

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w =

x =

y =

z =

Dear :

This letter responds to your December 22, 2003 letter requesting a ruling on certain federal income tax consequences of a proposed transaction. The information submitted in your request and subsequent correspondence is summarized below.

Summary of Facts

Corporation 1 is a State X professional corporation engaged in Business A. Corporation 1 has u shareholders, each of whom owns v shares of Corporation 1. State X law requires each Corporation 1 shareholder to hold a license that authorizes the shareholder to render the professional services described in Corporation 1's articles of incorporation. If a Corporation 1 shareholder loses his or her professional license, State X law requires Corporation 1 to redeem such shareholder's shares. Corporation 1 has licensure agreements with its shareholders which obligate the shareholders to maintain their professional licenses.

Corporation 2 is a State X corporation engaged in Business B. The same shareholders who own the stock of Corporation 1 also own the stock of Corporation 2, however, their proportional ownership in Corporation 2 is different from their ownership in Corporation 1. A minority of the shareholders hold a majority of Corporation 2 shares.

For certain business reasons, Taxpayer proposes to merge Corporation 2 into Corporation 1 pursuant to State X law in a transaction qualifying under Section 368 of the Internal Revenue Code (the "Code"). In order to effect the transaction, Corporation 1 will create a new class of stock, Preferred. In the transaction, the shareholders of Corporation 2 will exchange each of their Corporation 2 Common shares for w shares of Preferred.

Preferred is non-voting stock with a par value of \$x and is entitled to a cumulative annual dividend of y% of its par value. Additionally, Preferred holders are entitled to z% of any operating dividends paid with respect to Corporation 1 Common. Upon liquidation, holders of Preferred are entitled to a priority distribution of any corporate

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assets after payments to creditors equal to par value of Preferred plus any accumulated dividends.

Applicable Law

Section 354(a) of the Code states that no gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance to the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

Section 354(a)(2)(C) of the Code states that nonqualified preferred stock (as defined in section 351(g)(2)) received in exchange for stock other than nonqualified preferred stock (as so defined) shall not be treated as stock or securities.

Section 351(g)(2) of the Code states that “nonqualified preferred stock” means preferred stock if—

- (i) the holder of such stock has the right to require the issuer or related person to redeem or purchase the stock,
- (ii) the issuer or a related person is required to redeem or purchase such stock,
- (iii) the issuer or a related person has the right to redeem or purchase the stock and, as of the issue date, it is more likely than not that such right will be exercised, or
- (iv) the dividend rate on such stock varies in whole or in part (directly or indirectly) with reference to interest rates, commodity prices, or other similar indices.

Section 351(g)(3)(A) states that “preferred stock” means stock which is limited and preferred as to dividends and does not participate in corporate growth to any significant extent.

Representation

As of the date of the issuance of Preferred, Corporation 1 and its shareholders have not and will not have entered into any agreement granting Corporation 1 shareholders the right to require Corporation 1 or a related person (as described in section 267(b) or 707(b)) to redeem or purchase Preferred, or requiring Corporation 1 or a related person (as described in section 267(b) or 707(b)) to redeem or purchase Preferred before twenty years and one day following the issuance of Preferred, except in the case of a shareholder’s (1) death, (2) disability, or (3) mental incompetency.

Ruling

Based solely on the information and representations submitted, we rule that Preferred does not constitute nonqualified preferred stock within the meaning of section 351(g)(2).

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Caveats and Procedural Statements

The ruling contained in this letter is 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 a ruling, it is subject to verification on examination.

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 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,

Gerald Fleming
Senior Technician Reviewer
Office of Associate Chief Counsel
(Corporate)