



\$c =

\$d =

\$e =

\$f =

\$g =

\$h =

\$i =

\$j =

k =

l =

m =

\$n =

o =

\$p =

q =

Preferred Stock =

Company X =

Company Y =

Dear :

This letter responds to your letter dated August 20, 2004, which requests rulings on the application of sections 382(l)(3)(C) and 382(h). Additional information was received in a letter dated February 15, 2005. The material information submitted for consideration is summarized below.

## SUMMARY OF FACTS

Taxpayer is the common parent of an affiliated group of corporations that files a consolidated calendar year federal income tax return using the accrual method of accounting (the "Taxpayer Group"). All of the stock of Taxpayer is indirectly owned by Parent. Taxpayer is a holding company that owns all of the outstanding stock of Sub1 and Sub2. Sub1 owns all of the outstanding stock of Sub3.

Prior to Date 1, Parent had a single class of common stock outstanding. On Date 1, Parent issued a shares of Preferred Stock to Company X for an aggregate purchase price of \$b (\$c per share). The Preferred Stock constitutes stock for section 382 purposes. At all times since the issuance of the Preferred Stock, Company X has been an indirect subsidiary of Company Y. Company X has continuously held the Preferred Stock since it was issued.

Following Date 1, Sub1 and Sub3 increased their tax reserves for Year 1 by approximately \$d and \$e, respectively. The tax deductions attributable to these additions to reserves significantly contributed to the Taxpayer Group's Year 1 net operating loss of approximately \$f. Similarly, in Year 2, Sub1 and Sub3 increased their tax reserves by approximately \$g and \$h, respectively. The tax deductions attributable to these additions to reserves significantly contributed to the Taxpayer Group's Year 2 net operating loss of approximately \$i.

In addition, during this time, Taxpayer's business was deteriorating. Following Date 1, Parent's common stock declined in value relative to the value of its Preferred Stock, in part as a result of the additions to reserves and the business deterioration. At no time after the end of Year 1 has Parent's common stock traded at more than \$j.

On Date 2, Taxpayer filed a petition with the bankruptcy court for relief under Chapter 11 of the United States Code. During the period beginning with Date 1 and ending on Date 2, certain owner shifts occurred as a result of purchases and sales of Parent's common stock. These owner shifts were as follows: (1) approximately k shares of Parent common stock were acquired by employees and directors of the Taxpayer group (and related entities) pursuant to employee and director stock purchase plans; (2) l restricted shares of Parent common stock vested, resulting in m shares of Parent common stock being issued on Date 3, when the stock was trading at approximately \$n, and o shares of Parent common stock being issued on or about Date 4, when the stock was trading at approximately \$p per share; and, (3) higher tier entities with respect to Taxpayer disposed of q shares of Parent common stock (the "Parent Owner Shifts").

Taxpayer expects to emerge from bankruptcy under a plan of reorganization (the "Plan") that will result in an ownership change within the meaning of section 382(g) (the "Plan Ownership Change"). Subsequent to consummation of the Plan and the Plan Ownership Change, Sub1 expects to realize income as a result of extinguishing

obligations under contracts in amounts that are less than the reserves associated with such contracts (“Commutation Income”), thus reversing some of the reserves previously taken.

## RULINGS

Based solely on the information submitted as set forth above, for purposes of factoring out changes in proportionate ownership of Taxpayer’s stock which are attributable solely to fluctuations in the relative fair market values of different classes of stock under section 382(l)(3)(C), we hold that Taxpayer may apply the following principle with respect to the Parent Owner Shifts:

On any testing date, in determining the ownership percentage of any 5% shareholder, the value of such shareholder’s stock, relative to the value of all other stock of Taxpayer, shall be considered to remain constant since the date that shareholder acquired the stock; and the value of such shareholder’s stock relative to the value of all other stock of Taxpayer issued subsequent to such acquisition date shall also be considered to remain constant since that subsequent date.

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. Further, in the event that any shareholder acquired stock prior to the beginning of the testing period, no opinion is expressed regarding whether the principle described above should apply to factor out the effect of fluctuations in value of such stock relative to the value of other stock that occur prior to the testing period.

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.

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 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 representatives.

Sincerely,

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Mark S. Jennings  
Branch Chief, Branch 1  
(Corporate)

cc: