Internal Revenue Service

Index Number: 367.03-00

Number: **200021046**
Release Date: 5/26/2000

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:Br.4-PLR-116267-99
Date:
Febrtuary 28, 2000

UST	=
State A	=
Year B	=
business aa	=
Area bb	=
Area cc	=
Date C	=
FA	=
Country D	=
Year E	=
FAA	=
Year F	=
USP	=
State G	=
$150x	=
$145x	=
Date H	=
$155x	=

$140x =

Date I =

$50x =

Dear:

This is in reply to your letter dated October 4, 1999, requesting rulings under Treas. Reg. §1.367(a)-3(c)(9), that, based on your representations, the exchange of shares by U.S. persons will qualify for an exception to the general rule of section 367(a)(1) of the Internal Revenue Code of 1986, as amended (the Code). Additional information was provided in a letter dated January 28, 2000.

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.

UST is a domestic corporation incorporated under the laws of State A. UST is the common parent corporation of an affiliated group of companies which files a consolidated federal income tax return. UST was created in Year B and has been actively engaged in business aa since its inception. UST has significant operations in the United States and Area bb, and some operations in Area cc as well.

Prior to Date C, UST had issued outstanding shares in one class of common stock, which were publicly traded on a U.S. stock exchange. UST had issued options to its officers and employees as part of its incentive compensation plans.

FA, a Country D corporation, serves as the parent company to a number of subsidiaries with worldwide operations. FA was formed in Year E and has been actively engaged in business aa. Prior to FA's acquisition of UST, FA's principal operations were in Country D, the United States and Area cc. Upon completion of the acquisition, FA changed its name to FAA.

FA has issued and outstanding common shares and options to purchase common shares. FA has no other classes of shares issued or outstanding. Since Year F, FA's common shares have been listed on a Country D stock exchange.

FA and UST agreed to combine their businesses. On Date C, the combination of UST and FA occurred as follows (the "Combination"). FA contributed stock representing less than fifty percent of its outstanding shares to USP, a wholly owned subsidiary of FA organized under the laws of State G. USP then formed a transitory

State A subsidiary ("U.S. Newco") and contributed the FA stock to U.S. Newco in exchange for stock of U.S. Newco. U.S. Newco then merged into UST, with UST surviving. The holders of UST common shares received, in exchange for their UST common shares, common shares of FA. In addition, the shareholders of UST exchanged all outstanding options in UST for similar options in FA pursuant to the exchange. The taxpayers represent that the Combination qualified as a reorganization under section 368(a)(1)(B) of the Code, by virtue of Rev. Rul. 74-565, 1974-2 C.B. 125 (thus, the Combination is treated as if USP acquired the stock of UST in exchange for stock of USP's parent company, FA, in a transaction that qualifies as a "triangular B" reorganization under section 368(a)(1)(B)).

Under Treas. Reg. §1.367(a)-3(d)(1)(iii), if a U.S. person exchanges stock of the acquired corporation (UST) for voting stock of a foreign corporation (FA) that is in control of the acquiring corporation (USP) in connection with a "triangular B" reorganization, the exchanging U.S. person will be treated as having made an indirect transfer of the stock of the acquired corporation to a foreign corporation that is subject to the rules of §1.367(a)-3. The exchange of UST common stock for FA shares by U.S. persons is subject to §1.367(a)-3(c), which provides that the transfer of domestic stock by a U.S. person to a foreign corporation in a transaction that would otherwise qualify as a nonrecognition exchange is treated as a taxable transfer unless the requirements of Treas. Reg. §1.367(a)-3(c)(1) are satisfied.

Among the Treas. Reg. Section 1.367(a)-3(c)(1) requirements is the requirement that the U.S. target company satisfy the reporting requirements of Treas. Reg. Section 1.367(a)-3(c)(6), and the requirement that each U.S. transferor who is a 5-percent shareholder of the transferee foreign corporation immediately after the exchange enter into a 5-year gain recognition agreement as provided in section 1.367(a)-8. The taxpayers represent that UST, as the U.S. target company, will satisfy the reporting requirements of section 1.367(a)-3(c)(6). The remaining section 1.367(a)-3(c)(1) requirements are as follows:

a) U.S. persons transferring U.S. target stock must receive, in the aggregate, 50 percent or less of both the total voting power and total value of the stock in the transferee foreign corporation (taking into account the attribution rules of section 318 of the Code, as modified by the rules of section 958(b) of the Code). The taxpayers represent that U.S. transferors of UST stock received, in the aggregate, actually or constructively, 50 percent or less of both the total voting power and total value of the stock in FA in the UST stock exchange.

   For purposes of this test, options (or interests similar to options) are treated as exercised and thus counted as stock for purposes of determining whether the 50-percent threshold is exceeded if a principal purpose of the issuance or acquisition of the options (or similar interests) was the avoidance of the general rule under section 367(a)(1). UST issued stock options to its officers and employees pursuant to long-standing employee incentive plans. While options under these plans were issued to certain key officers of UST after the announcement of the Combination, the taxpayer represents that such options were issued to those officers because

and such options served as protection in the event employment was terminated after the Combination. Thus, the taxpayer represents that the stock options were not issued for the purpose of satisfying the 50-percent threshold in §1.367(a)-3(c)(1)(i).

b) U.S. persons who are officers or directors of the U.S. target corporation, or who are 5-percent shareholders of the U.S. target corporation, must own, in the aggregate, 50 percent or less of each of the total voting power and the total value of the stock of the transferee foreign corporation, immediately after the exchange of the U.S. target stock (taking into account the attribution rules of section 318, as modified by the rules of section 958(b)). The taxpayers represent that U.S. persons who are officers, directors, or 5-percent target shareholders of UST owned, in the aggregate, actually or constructively, 50 percent or less of each of the total voting power and total value of the stock of FA immediately after the UST exchange.

c) The active trade or business test of Treas. Reg. Section 1.367(a)-3(c)(3) must be satisfied. The three elements of the active trade or business test are described below:

   (i) The transferee foreign corporation (or any qualified subsidiary or qualified partnership as defined under section 1.367(a)-3(c)(5)(vii) and (viii)) must have been engaged in the active conduct of a trade or business outside the United States, within the meaning of sections 1.367(a)-2T(b)(2) and (3), for the entire 36-month period immediately preceding the exchange of U.S. target stock. The taxpayers represent that FA (or its qualified subsidiaries) were engaged in an active trade or business outside the United States for the entire 36-month period preceding the UST exchange.

   (ii) At the time of the exchange, neither the transferors nor the transferee foreign corporation (or any qualified subsidiary or qualified partnership engaged in the active trade or business) will have the intention to substantially dispose of or discontinue such trade or business. The taxpayers represent that neither the shareholders of UST nor FA (including its qualified subsidiaries) had an intention to substantially dispose of or discontinue such active trade or business.

   (iii) The substantiality test as defined in Treas. Reg. Section 1.367(a)-

3(c)(3)(iii) must be satisfied.

Under the substantiality test, the transferee foreign corporation must be equal or greater in value than the U.S. target corporation at the time of the U.S. target stock exchange (see section 1.367(a)-3(c)(3)(iii)(A)). The taxpayers represent that the market capitalization of FA ($150x) exceeded the market capitalization of UST ($145x) on the date the Combination closed. On Date H, the day before the announcement of the Combination, FA's market capitalization ($155x) exceeded UST's market capitalization ($140x) by an even larger amount, although the corporations' market capitalizations were closer in value by the time of the exchange (with FA still larger than UST at the date of closing).

For purposes of the substantiality test, the value of FA would have to be discounted or reduced by the amount of certain prohibited assets acquired outside the ordinary course of business by FA or any of its qualified subsidiaries within the 36-month period preceding the exchange, as provided in §1.367(a)-3(c)(3)(iii)(B) (commonly referred to as the "stuffing rule"). On Date I, within the 36-month period preceding the exchange, FA raised approximately $50x dollars in a public offering of its common stock on a Country D stock exchange. The taxpayer represents that the proceeds of the Date I public offering were intended specifically and exclusively to fund the acquisition of an unrelated domestic corporation in a transaction that would have been taxable for U.S. tax purposes. While the acquisition of the domestic corporation was terminated because of an unexpected increase in the price of the domestic corporation's stock, the taxpayer represents that the reasons for undertaking the public offering were unrelated to any intention to acquire UST, or any other domestic corporation, in a transaction designed to qualify for nonrecognition treatment. Thus, the taxpayer represents that FA did not undertake the Date I public offering for any purpose related to satisfying the stuffing rule. The taxpayer has also submitted documentation to substantiate this representation.

The taxpayer further represents that, for purposes of the substantiality test of Treas. Reg. section 1.367(a)-3(c)(3)(iii)(B), the fair market value of FA will not include the fair market value of any asset acquired by FA, a qualified subsidiary, or a qualified partnership outside the ordinary course of business within the 36-month period preceding the Merger for the principal purpose of satisfying the substantiality test of section 1.367(a)-3(c)(3)(iii). Also, for purposes of this fair market value representation, the taxpayer represents that the fair market value of FA (including the value of stock in any qualified subsidiary or an interest in any qualified partnership) will include assets producing, or held for the production of, passive income as defined in section 1297(b) (formerly section 1296(b)) which assets were acquired outside the ordinary course of business within the 36-month period preceding the UST stock exchange only to the extent such assets were acquired in a transaction which was not undertaken for a purpose of satisfying the substantiality test.

The taxpayer requests a ruling under Treas. Reg. §1.367(a)-3(c)(9) that there is substantial compliance with the active trade or business test notwithstanding that the "stuffing rule", as described in section 1.367(a)-3(c)(3)(iii)(B), may not be met due to the acquisition by FA of certain passive assets not undertaken for a purpose of satisfying the substantiality test.

Under Treas. Reg. §1.367(a)-3(c)(9), the Service may, in limited circumstances, issue a private letter ruling to permit the taxpayer to qualify for an exception to section 367(a)(1), if the taxpayer is unable to satisfy all the requirements of the active trade or business requirements but is in substantial compliance with such test and meets all of the other requirements of §1.367(a)-3(c)(1).

Based solely on the information submitted and on the representations set forth above, it is held as follows:

(1) The transfer of the UST shares by U.S. persons in exchange for shares of FA will qualify for an exception to section 367(a)(1) (§1.367(a)-3(c)(1) and § 1.367(a)-3(c)(9)).

(2) Any U.S. person transferring UST shares who is a 5-percent transferee shareholder (as defined in section 1.367(a)-3(c)(5)(ii)) will qualify for the exception to section 367(a) only upon entering into a 5-year gain recognition agreement pursuant to §1.367(a)-8.

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. In particular, no opinion was requested and none is expressed as to whether the UST stock exchange qualifies as a reorganization within the meaning of section 368(a)(1)(B) of the Code, by virtue of Rev. Rul. 74-565. In addition, no opinion is expressed as to the reporting requirements of U.S. persons exchanging their UST stock under section 6038B and the regulations thereunder.

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 the taxpayer.

Sincerely,
Charles P. Besecky, Chief, Branch 4
Office of Associate Chief Counsel (International)

cc: