In re:

TY:

Legend

Foreign Acquirer =

Subsidiary =

Target =

Company =

Year 1 =

Year 2 =

Country A =

B =
Dear:

This is in response to your letter, dated March 28, 2002, requesting a private letter ruling that based on your representations, the proposed merger of Target with and into a wholly-owned subsidiary of Foreign Acquirer 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 submitted in letters dated August 26, 2002, September 6, 2002, and September 18, 2002.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalties 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 the rulings, it is subject to verification upon examination.

Foreign Acquirer is a publicly traded corporation in a personal service business. It has one major shareholder, a non-U.S. individual who is the Chairman of the Supervisory Board and whose family founded Foreign Acquirer. It was founded in Year 1 and incorporated in Country A in Year 2.

Target is a holding company incorporated in Delaware and is in the same personal service business as the Foreign Acquirer and. Target stock is not publicly traded. It has two classes of common stock outstanding, a Class A shares owned by approximately b employees and former employees and c Class B shares owned by Company, a foreign corporation. The economic rights of the Class A and B common stock are identical although the Class B common stock has greater voting power.

On Date 1, Foreign Acquirer and Target announced the proposed merger (Merger) whereby Foreign Acquirer will acquire the Target common stock and cash out approximately d Target options in exchange for an estimated $e in stock and equity-based securities. The market value of Foreign Acquirer on Date 2 was approximately $f. The consideration to be issued by Foreign Acquirer for these purposes would consist of g Foreign Acquirer ordinary shares, ORA’s issued pursuant to Section L 228-91 of the B Commercial Code that are mandatorily redeemable for h Foreign Acquirer ordinary shares, and OBSA’s which are notes with detachable warrants to acquire h Foreign Acquirer ordinary shares. The ORA’s and detachable warrants were designed to reduce the short-term dilution in voting power of the Foreign Acquirer controlling shareholders. The warrants will be detached from the notes immediately after closing and distributed to the Target shareholders. Each warrant entitles the holder to purchase one Foreign Acquirer ordinary share and is exercisable at any time from the anniversary to the anniversary of the issue date.

Following an arm’s length negotiation between Company and a special committee of Target’s disinterested directors, the parties agreed to the following steps to accomplish the dual objectives of obtaining cash proceeds for the Class A shareholders and allowing Company to achieve equity accounting for its Foreign Acquirer investment. Company will acquire shares of Class A common stock from the Class A shareholders at a price of $i per share and voting power over additional shares in Foreign Acquirer for a temporary period. First, prior to the closing of the Merger, Subsidiary, a transitory subsidiary of Target will merge with and into Target in the “Preliminary Merger”, and Company will acquire Class A shares from the Class A shareholders for an aggregate amount of $j, in a transaction constituting a purchase of Class A common stock by Company followed by a conversion of the acquired stock into Class B common stock. Second, the Merger agreement between Foreign Acquirer and Target provides that the voting rights on approximately 25% of the Foreign Acquirer shares issued to the Class A Target shareholders will be transferred to Company for a
-year period. This will be accomplished by splitting the right to vote from the economic interest in these shares as permitted under B law. The Class A shareholders will retain usufruct with all economic rights, but Company will receive the bare legal title with all voting rights for the 2-year period. Based on these transactions, after the merger, the former Class A shareholders of Target will own approximately 14% of the value (as distinguished from voting power) of the outstanding stock in Foreign Acquirer, and Company will own approximately 15%. Assuming all of the warrants are exercised and the ORAs are converted to common stock of Foreign Acquirer, former Class A shareholders of Target will own approximately 27% of Foreign Acquirer and Company will own approximately 15%. Foreign Acquirer and Target represent that the proposed Merger qualifies under section 368(a)(1)(A) by reason of section 368(a)(2)(D).

The exchange of Target shares by U.S. persons is subject to section 367(a) of the Code, which provides that where no exception applies, the transfer of appreciated property (including 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. In the case of a section 367(a) transaction in which a U.S. person transfers domestic stock to a foreign corporation, the U.S. transferor will qualify for nonrecognition treatment only if the requirements of Treas. Reg. section 1.367(a)-3(c)(1) are satisfied.

Among the requirements of Treas. Reg. section 1.367(a)-3(c)(1) is the requirement that the U.S. target company must satisfy the reporting requirements of Treas. Reg. section 1.367(a)-3(c)(6). Target represents that it will comply with the reporting requirements of Treas. Reg. section 1.367(a)-3(c)(6). Another requirement is 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. Foreign Acquirer and Target (the “Taxpayers”) represent that each U.S. shareholder that is a 5-percent shareholder of Foreign Acquirer after the Merger and will enter into a five-year gain recognition agreement with respect to Target stock it exchanged in the form provided in Treas. Reg. section 1.367(a)-8.

Among the remaining requirements of section 1.367(a)-3(c)(1) is the requirement that 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 Target stock will receive, in the aggregate, actually or constructively, 50-percent or less of both the total voting power and total value of all shares of Foreign Acquirer stock outstanding after the Merger. The Taxpayers represent that the 50-percent threshold will be satisfied even if all the stock options, convertible notes, and exchangeable shares in Foreign Acquirer received in the Merger exchange for shares of Target were subject to section 1.367(a)-3(c)(4)(ii) and treated as exercised and exchanged for Foreign Acquirer stock. Another requirement is
that 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 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 Taxpayer represents that U.S. persons who are officers, directors, or 5-percent target shareholders of Target will own in the aggregate, actually or constructively, 50-percent or less of each of the total voting power and total value of all shares of Foreign Acquirer outstanding immediately after the Merger.

The active trade or business test of Treas. Reg. section 1.367(a)-3(c)(3) must be satisfied. The active trade or business test consists of three elements. The first element provides that 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 Foreign Acquirer or one or more of its “qualified subsidiaries” (as defined in Treasury Regulation Section 1.1.367(a)-3(c)(5)(vii) will have been engaged in the active conduct of a trade or business outside the United States (the “Foreign Acquirer Business”), within the meaning of Treas. Reg. sections 1.367(a)-2T(b)(2) and (3), for the entire 36-month period immediately preceding the Merger.

The second element of the active trade or business test provides that 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 Target, nor Foreign Acquirer (including its qualified subsidiaries or qualified partnerships), will have any plan or intention to substantially dispose of, or discontinue, the Foreign Acquirer Business.

The third element of the active trade or business test is the substantiality test as defined in Treas. Reg. section 1.367(a)-3(c)(3)(iii). 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 Foreign Acquirer the day before the Merger was announced was $f and exceeded the estimated $e consideration arrived at in arm’s length negotiations to be applied to acquire Target. Pursuant to Treas. Reg. section 1.367(a)-3(c)(3)(iii)(B)(1) the value of the transferee foreign corporation is reduced by the amount of any asset acquired outside the ordinary course of business by such corporation or any of its qualified subsidiaries or qualified partnerships within the 36-month period preceding the exchange to the extent that (i) at the time of the exchange such asset produces or is held for the production of passive income, as defined in section 1297(b)
or (ii) such asset was acquired for the principal purpose of satisfying the substantiality test (commonly referred to as the “stuffing” rule). In addition, pursuant to Treas. Reg. section 1.367(a)-3(c)(3)(iii)(B)(3) the value of the transferee foreign corporation is reduced by the value of assets received within the 36-month period prior to the acquisition if such assets were owned by the U.S. target company or an affiliate. Taxpayers represent that, at Closing, neither Foreign Acquirer, nor any of its qualified subsidiaries or qualified partnerships, if applicable, will hold any assets that were acquired for the principal purpose of satisfying the substantiality test of Treas. Reg. section 1.367(a)-3(c)(3)(iii).

For purposes of the substantiality test, the value of Foreign Acquirer would have to be discounted or reduced by the amount of certain prohibited assets acquired outside the ordinary course of business by Foreign Acquirer or any of its qualified subsidiaries within the 36-month period preceding the exchange, as provided in section 1.367(a)-3(c)(iii)(B) (commonly referred to as the “stuffing rule”). Foreign Acquirer made two public debt offerings, one on Date 3 and the second on Date 4. The Date 3 exchangeable notes raised approximately $k in U.S. dollars, and the Date 4 convertible bonds raised approximately $m in U.S. dollars. Foreign Acquirer represents that the exchangeable notes and the convertible bonds constituted debt and not equity. Foreign Acquirer represents that the debt offerings were issued in order to raise capital for general financing needs, to permit refinancing of previous acquisitions and to manage financing costs efficiently, not for any purpose related to satisfying the substantiality test.

If all of the assets acquired during the past 36 months were excluded when determining the value of Foreign Acquirer, it would not meet the substantiality test. The Taxpayer requests a ruling under §1.367(a)-3(c)(9) that there will be substantial compliance with the active trade or business test.

The issue of whether a transaction constitutes a corporate reorganization within the meaning of section 368(a)(1)(A) (including a transaction that qualifies under section 368(a)(1)(A) by reason of section 368(a)(2)(D)) is an “area in which rulings or determination letters will not be issued.” See section 3.01(30) of Rev. Proc. 2002-3, 2002-1 I.R.B. 117,119.

Based solely on the information submitted and on the representations set forth above, provided the notes and convertible bond constitute debt and not equity, and subject to the caveats below, it is held as follows:

The transfer of Target shares by US persons for shares of Foreign Acquirer will qualify for an exception to section 367(a)(1) under Treas. Reg. section 1.367(a)-3(c)(1) and (9).
No opinion is expressed as to the value or valuation of the Target stock and the Foreign Acquirer stock. No opinion is expressed as to the value of the Foreign Acquirer stock or any other consideration received by the Target shareholders. Furthermore, no opinion is expressed on the tax effects of the merger if the equity consideration issued to the Target shareholders in the merger drops below 50 percent of the total consideration issued to the Target shareholders. No opinion is expressed as to the tax treatment of the transaction under other provisions of the Code and regulations, and no opinion is expressed about the tax treatment of any conditions existing at the time of, or effects resulting from the transactions that are not specifically covered by this ruling. In particular, no opinion was requested and no opinion is provided as to whether the transaction will qualify for nonrecognition treatment under sections 351 or 368 of the Code. No opinion is expressed as to the reporting requirements of U.S. persons exchanging stock under section 6038B and the regulations thereunder.

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.

It is important that a copy of this letter be attached to the federal income tax return of the taxpayer involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Sincerely,

Michael H. Frankel
Senior Technical Reviewer, Branch 4
Office of Associate Chief Counsel
(International)

cc: