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Year 1 =

Year 2 =

Dear :

This letter responds to a letter dated August 3, 1998, and prior correspondence submitted on behalf of X, Family, and Newco and requesting rulings under various sections of the Internal Revenue Code.

FACTS

You have represented that the facts are as follows. Family includes Father, Children, and Trusts, which were set up by Father for Children and other of his offspring. Family members together own 100% of X, an S corporation. X's principal asset is an x% general partnership interest in PRS1, a State1 limited partnership. PRS2, a general partnership consisting of members unrelated to any member of Family, owns the remaining y% as a limited partner.

PRS1 is the sole general partner of PRS3, a State1 limited partnership. The value of PRS11s general partnership interest in PRS3 is approximately $x. PRS3's limited partner is a publicly held corporation with no relationship to any member of Family.

Family also owns 100% of the stock of Y, an S corporation. Y's principal asset is an x% general partnership interest in PRS4, a State1 limited partnership. PRS2 owns the remaining y% as a limited partner. PRS4 is the sole general partner of PRS5, a State1 limited partnership. The value of PRS4's general partnership interest in PRS5 is approximately $y. PRS5's limited partner is a trust with no relationship to any member of Family.

Family also owns x% of the stock of Z, a domestic C corporation. All but z% of the remaining y% of Z's stock is owned directly or indirectly by the partners of PRS2. The remaining z% is owned by persons with no relationship to any member of Family.

Z's principal asset is 100% of the stock of Q, a domestic C corporation. Q's principal asset is an q% general partnership interest in PRS6, a State2 general partnership. PRS6's other partners are partnerships or corporations with no other relationship to Family.

PRS3, along with PRS5 and PRS6, was formed to design, construct, own, and operate a combined cycle cogeneration power plant that produces electric power and steam. The electric power produced by the PRS3 plant is provided to Utility pursuant to a power purchase agreement (the PPA) dated Date 1.

The PPA was entered into pursuant to the Public Utility Regulatory Policies Act of 1978 (PURPA) and State2's implementation thereof. PURPA generally requires electric utilities to purchase power from qualifying cogeneration facilities unless the purchase would result in greater costs for the utility than if the utility itself had generated the power.

The base term of the PPA is P years from the date of commencement of commercial operations, which occurred in Month. The PPA requires Utility to make certain payments to PRS3 in exchange for exclusive access to all of the electricity the plant is capable of producing (subject to certain seasonal capacity limitations).

The payments made by Utility consist of both variable and fixed portions. The Fuel Component portion of the Monthly Energy Charge is the variable portion of the payment. It is a charge per kilowatt-hour delivered to Utility that will vary monthly depending upon the market cost of fuel.

The fixed payment consists of the fixed component portion of the Monthly Energy Charge, the GNP Deflator Component portion of the Monthly Energy Charge, and the Monthly Capacity Charge. The fixed component portion of the Monthly Energy Charge is equal to $z per kilowatt-hour delivered to Utility, and will remain unchanged over the P year term of the PPA. The GNP Deflator Component portion is a fixed formula payment based on an amount per kilowatt-hour delivered. The amount is adjusted annually based on a government-produced deflator number. The Monthly Capacity Charge consists of a seasonal fixed payment per kilowatt-hour delivered during certain months of the year. This payment increases by r% per year.

The fixed payments are not based on the plant's variable operating costs. Instead, they are based on the formulas described above. The fixed payments approximate the fixed costs of constructing, operating, and maintaining an electric generating plant that Utility was able to avoid by contracting with PRS3.

Due to changes in the marketplace, utilities are no longer entering into long-term contracts that provide for payments like the fixed payments. As a result, the payments required under the PPA are substantially in excess of the current market value of electricity, thereby resulting in the PPA's above market value.

Family, the partners of PRS2, and the other shareholders of Z would like to obtain access to public debt and equity markets to maximize current opportunities existing in the power generation business. Therefore, the owners propose to combine, directly or indirectly, the ownership of the cogeneration business in a new corporation (Newco) in conjunction with a public offering of securities of Newco (Secondary Public Offering" [sic] or "SPO"). Accordingly, the following transaction has been proposed:

(i) Family and PRS2 will form Newco in exchange for x% and y% of the shares of Newco common stock, respectively. Newco was formed prior to the Closing solely to permit registration of its common stock with the Securities and Exchange Commission, to enable it to acquire all of the outstanding stock of X at the Closing, and to engage in other transactions as described herein. Except for activities incident to these actions, prior to the Closing Newco will have no activities and will carry on no business.

(ii) Family will enter into an agreement with Newco to transfer 100 percent of the stock of X to Newco in exchange for shares of the common stock of Newco plus cash of approximately $q (Sale1).

(iii) Family and Newco will agree to make a section 338(h)(10) election with respect to the transfer of the X stock to Newco.

(iv) PRS2 will enter into an agreement to transfer its y% partnership interest in PRS1 to Newco in exchange for shares of the common stock of Newco (Exchange 1).

(v) Y and PRS2 will enter into an agreement with Newco to transfer slightly less than t% of their respective x% and y% partnership interests in PRS4 to Newco in exchange for shares of common stock of Newco (Exchange2).

(vi) Simultaneously with entering into their agreements to make these transfers to Newco, Family, Y, and PRS2 will enter into a firm commitment underwriting agreement (the Underwriting Agreement) with Underwriter as the lead managing underwriter of the SPO pursuant to which Family, Y, and PRS2 will sell a substantial portion of the Newco shares they will receive in Sale1, Exchange1, and Exchange2 in a SPO of such shares. There will be no initial public offering ("IPO") of Newco stock. That is, Newco itself will offer no shares of Newco stock to the public. The only Newco shares offered to the public will be the Newco shares offered through the SPO. The Underwriting Agreement will require Family, Y, and PRS2 to sell a sufficient number of Newco shares so that, immediately after the SPO, (i) Family, Y, and PRS2, along with PRS7 and T (both described and discussed below) will own, in the aggregate, significantly less than 80 percent of the total combined voting power of all classes of stock entitled to vote and 80 percent of the total number of shares of all other classes of stock of Newco and (ii) Family, Y, PRS7, and T will own, in the aggregate, significantly less than 50 percent of the total combined voting power of all classes of stock entitled to vote and 50 percent of the total value of shares of all classes of stock of Newco (the Committed Shares).

(vii) Family, Y, PRS2, and Newco will then close Sale1, Exchange 1, [sic] and Exchange2 (the "Closing"). Newco will contribute the stock of X to a newly formed single member limited liability company. Newco will also transfer PRS2's partnership interest in PRS1 to a wholly- owned subsidiary of Newco.

(viii) Concurrently with the closing, the shareholders of Z will cause Z to merge pursuant to state law with a subsidiary of Newco solely in exchange for Newco stock (the "Z Merger").

(ix) Immediately after the closing and the Z Merger, Family, Y, and PRS2 will sell the Committed Shares in the SPO pursuant to the terms of the Underwriting Agreement.

(x) The interests of Y and PRS2 remaining in PRS4 following Exchange2 will be redeemed by PRS4 (Redemption1) in consideration of a distribution to Y and PRS2 of PRS4's note receivable from PRS7 and cash in an amount equal to the excess of the value of the redeemed partnership interests over the value of the distributed note receivable.

As part of the consolidation of the cogeneration business, Family and PRS2 will enter into the following related transactions. These transactions essentially consist of transfers of interests in various entities to Newco.

Family also owns 100 percent of the stock of R, an S corporation. R holds a u% general partnership interest in PRS7. The limited partnership interests are held v% and y% by Family and PRS2, respectively. PRS7 holds 100 percent of the stock of U, a Country corporation electing to be taxed under section 953(d) as a domestic corporation for U.S. tax purposes. PRS7 will transfer 100 percent of the U to Newco, either directly or pursuant to a reverse subsidiary merger, solely in exchange for common stock of

Newco (Exchange3) in a transaction intended to qualify as a non-taxable reorganization undersection 368(a).

Family also holds 100 percent of the stock of T, an S corporation. T holds a u% percent general partnership interest in PRS8, a State1 limited partnership. The limited partnership interests are held w% and xx% by Family and PRS2, respectively. PRS8 owns a yy% preferred limited partnership interest in PRS9, an operating partnership engaged in the Cogeneration Business. The remaining limited partnership interests are held by unrelated third parties. T, Family, and PRS2 will transfer their respective partnership interests in PRS8 to Newco in exchange for common stock of Newco. Newco will transfer the general partnership interest in PRS8 to a newly formed subsidiary of Newco, Sub1. Newco will transfer the limited partnership interests in PRS8 to a newly formed subsidiary of Newco, Sub2.

The following representations have also been made in connection with the proposed transaction:

(a) Newco and Family intend to make joint elections undersection 338(h)(10) by the 15th day of the 9th month beginning after the month in which the acquisition date (as defined in section 338(h)(2)) occurs with respect to the acquisition by Newco of all of the stock of X.

(b) Newco will not purchase any stock of X prior to the Closing (described in step (vii), above).

(c) All of X's outstanding stock will be acquired by Newco at the Closing.

(d) For the taxable period of X that includes the date of the Closing, X will be an S corporation as defined in section 1361, and 100 percent of the outstanding capital stock of X will be held by Family.

(e) Newco was formed prior to the Closing solely to permit registration of its common stock with the Securities and Exchange Commission, to enable it to acquire all of the outstanding stock of X at the Closing, and to engage in other transactions as described herein. Except for activities incident to these actions, prior to the Closing Newco will have no activities and will carry on no business.

(f) The fair market value of X's assets will exceed its liabilities (including any amount owed to any member of Family) at the Closing.

(g) Newco has not acquired and, prior to the filing of elections under section 338(h)(10) and during the required consistency period, will not acquire, any assets of X.

(h) There is no plan or intention for Newco or X to cease to remain in existence as separate corporations following the Closing.

(i) Pursuant to the Underwriting Agreement, Family, Y, and PRS2 will sell a sufficient number of Newco shares so that, immediately after the SPO, (i) Family, Y, PRS2, PRS7, and T will own in the aggregate significantly less than 80 percent of the total combined voting power of all classes of stock entitled to vote and 80 percent of the total number of shares of all other classes of stock of Newco and (ii) Family, Y, PRS7, and T will own in the aggregate significantly less than 50 percent of the total combined voting power of all classes of stock entitled to vote and 50 percent of the total value of shares of all classes of stock of

Newco. Family will not, actually or constructively, control both X and Newco after the sale of the Committed Shares pursuant to the Underwriting Agreement. For purposes of this representation, control is defined by section 304(c).

(j) The terms of the agreement between Family and Newco pursuant to which Family has agreed to transfer 100 percent of its stock in X to Newco will be determined in good faith negotiations between the parties, and the fair market value of the Newco shares received by Family from Newco in exchange for the X shares will be approximately equal to the fair market value of such X shares.

(k) Family, X, and Newco have paid or will pay their own expenses.

(l) Newco has no plan or intention to dispose of the X shares.

RULINGS REQUESTED

Based on the information submitted and the facts as represented above, you have requested that we rule as follows:

(1) The PPA is not an unrealized receivable for purposes of section 751(a)(1);

(2) The PPA is not an inventory item for purposes of section 751(a)(2);

(3) The acquisition of X stock by Newco is a "qualified stock purchase" within the meaning of section 338(d)(3);

(4) Family and Newco are entitled to make an election under section 338(h)(10); and

(5) The transfer of 100 percent of the outstanding stock of X by Family to Newco and the deemed sale of X's assets is not a sale or exchange of property, directly or indirectly, between related persons for purposes of section 1239(a).

LAW AND ANALYSIS

Section 741 provides that gain or loss recognized by a transferor partner upon the sale or exchange of an interest in a partnership is, except as otherwise provided in section 751, gain or loss from the sale or exchange of a capital asset.

Section 751(a) provides that the amount of money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in a partnership attributable to (1) unrealized receivables or (2) inventory items of the partnership is considered an amount realized from the sale or exchange of property other than a capital asset.

Under section 751(b), certain distributions are treated as sales or exchanges. Section 751(b)(1) provides that, to the extent a partner receives a distribution of unrealized receivables or inventory items that have appreciated substantially in value from the partnership in exchange for all or a part of his interest in partnership property, or the partner receives money or other property of the partnership in exchange for his

interest in partnership unrealized receivables or substantially appreciated inventory, the transaction may, as provided in regulations, be treated as a sale or exchange. This provision does not apply to a distribution of property that the distributee contributed to the partnership or to payments to a retiring partner or successor in interest of a deceased partner described in section 736(a).

Section 751(c) defines "unrealized receivables" as including any rights to payment for (1) goods delivered or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or (2) services rendered or to be rendered. Both types of rights are unrealized receivables only to the extent not previously includible in income under the partnership's method of accounting.

Section 751(d) provides that the term "inventory items" means property of the partnership of the kind described in section 1221(1) (property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business); any other property that, on sale or exchange by the partnership, would be considered property other than a capital asset and other than section 1231 property; any other property of the partnership that, if sold or exchanged by the partnership would result in gain taxable under section 1246(a) (relating to gain on foreign investment company stock); and any other property held by the partnership that, if held by the selling or distributee partner, would be considered property of the type described above.

Section 751(f) provides a special rule for tiered partnerships. In determining whether partnership property is section 751 property, a partnership is treated as owning its proportionate share of the property of any other partnership in which it is a partner.

The legislative history accompanying section 751(c) provides that the provision was enacted "in order to prevent the conversion of potential ordinary income into capital gain by virtue of transfers of partnership interests." H.R. Rep. No. 1337, 83d Cong., 2d Sess. 70 (1954) (House Report); S. Rep. No. 1622, 83d Cong., 2d Sess. 98 (1954) (Senate Report). Further, section 751(c) was "necessary to prevent the use of the partnership as a device for obtaining capital-gain treatment on fees or other rights to income." House Report at 71; Senate Report at 99.

The definition of unrealized receivable under section 751(c) does not include the PPA because it is a long-term contract for the sale of goods that confers a right that constitutes property and not merely a right to receive future income for goods or services delivered or to be delivered. We reach this conclusion because a direct sale of the contract by the partnership would be treated as the sale or exchange of property within the meaning of or sections 1221 or 1231.

Section 1239(a) provides that in the case of a sale or exchange of property, directly or indirectly, between related persons, any gain recognized to the transferor shall be treated as ordinary income if such property is, in the hands of the transferee, of a character which is subject to the allowance for depreciation provided in section 167.

Section 1239(b)(1) defines the term "related persons" as a person and all entities which are controlled entities with respect to such person.

Section 1239(c)(1) defines the term "controlled entity," with respect to any person, as (A) a corporation more than 50 percent of the value of the outstanding stock of which is owned (directly or indirectly) by or for such person, (B) a partnership more than 50 percent of the capital interest or profits interest in which is owned (directly or indirectly) by or for such person, and (C) any entity which is a related person to such person under or section 267(b)(3), (10), (11), or (12). Section 1239(c)(2) provides that ownership shall be determined in accordance with rules similar to the rules under section 267(c) (other than section 267(c)(3)).

The regulations under section 1239 do not reflect the changes made to section 1239(c)(1) by the Tax Reform Act of 1986, which, among other changes, substituted "more than 50 percent of the value" for "80 percent or more in value" for purposes of defining a "controlled entity." Thus, for purposes of section 1239(c)(1) and section 1.1239-1(c)(3)(ii) of the Income Tax Regulations, Sale1 between the transferor (Family) and transferee (Newco) will not be subject to section 1239 unless the transferee is controlled by the transferor "immediately after" the transfer. For this purpose, "controlled" is defined in section 1239(c)(1) as the transferor owning more than 50 percent in the value of the outstanding stock of the transferee corporation. Section 1239 and the regulations thereunder do not define the phrase "immediately after." However, "immediately after" has been interpreted by the courts for purposes of section 351 transactions.

Section 351(a) generally provides that no gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in the transferee corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the transferee corporation. Section 368(c) provides that the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the transferee corporation.

For purposes of nonrecognition treatment under section 351(a), even if stock constituting "control" of the transferee corporation is received by the transferor(s), the requirements of section 351(a) will not be satisfied if, pursuant to a binding agreement entered into prior to the transfer of property to the transferee corporation, the transferor(s) obligate themselves to transfer an amount of stock to a third party (who does not transfer property to the transferee corporation in the transaction) that would cause the transferor(s) no longer to be in control (within the meaning of section 368(c)) of the transferee corporation immediately after the transfer of such stock (the "Binding Commitment Doctrine"). See Hazeltine Corp. v. Commissioner, 89 F.2d 513 (3rd Cir. 1937); Intermountain Lumber, 65 T.C. 1025 (1976); Rev. Rul. 79-70, 1979-1 C.B. 144; and Rev. Rul. 70-522, 1970-2 C.B. 81. The Binding Commitment Doctrine has also been applied outside the section 351 context. See, e.g., Berry Petroleum Company v. Commissioner, 104 T.C. 584 (1995) (involving whether certain assets of a target

corporation were business or nonbusiness assets "immediately after" an ownership change of the target corporation for purposes of section 382(l)(4)).

The Binding Commitment Doctrine has been applied to determine whether a taxpayer owns stock "immediately after" a transaction for purposes of section 351(a) and for other tax purposes. It is therefore appropriate to apply the Binding Commitment Doctrine in determining the amount of a shareholder's stock ownership in a transferee corporation "immediately after" a sale of depreciable property to that corporation for purposes of section 1239(a).

Applying the Binding Commitment Doctrine to Sale1 results in Family, Y, PRS7, T, and PRS2, owning, in the aggregate, less than 80 percent of the total combined voting power and 80 percent of the value of Newco stock immediately after the SPO. However, section 1239(c)(1) and section 1.1239-1(c)(3)(ii) require the transferor to own, directly or indirectly, not more than 50 percent of the value of the outstanding stock of the transferee immediately after the transfer. X represents that Family, Y, PRS7, and T will own, in the aggregate, no more than 50 percent by value of the stock of Newco immediately after the SPO, and that PRS2 and Family are unrelated under section 1239(b). Accordingly, provided that Family and PRS2 are unrelated within the meaning of section 1239(b)(1); and provided that Family, X, PRS7, and T will own, in the aggregate, not more than 50 percent of the value of the stock of Newco immediately after the Closing and the SPO, the transfer of 100 percent of the outstanding stock of X by Family to Newco and the deemed sale of X's assets is not a sale or exchange of property, directly or indirectly, between related persons for purposes of section 1239(a).

Section 338(a) provides that, in the case of a qualified stock purchase ("QSP"), if the purchasing corporation makes an election, the target corporation is (1) treated as having sold all of its assets at the close of the acquisition date at their fair market value in a single transaction, and (2) is treated as a new corporation which purchased all of the assets of the "old target" as of the beginning of the day following the acquisition. An election under section 338 generally can be made pursuant to section 338(g) or section 338(h)(10). Shareholders of an S corporation may make a section 338(h)(10) election (section 1.338(h)(10)-1(a)).

A QSP is defined in section 338(d)(3) as "any transaction or series of transactions in which stock (meeting the requirements of section 1504(a)(2)) of 1 corporation is acquired by another corporation by purchase during the 12-month acquisition period." Since Newco will acquire all of the stock of X in a single day under the proposed transaction, Newco will have acquired X stock meeting the 80 percent requirement under section 1504(a)(2) and will have acquired it within the required 12-month period. As a result, the transfer of the X stock to Newco will qualify as a QSP so long as Newco acquired the X stock by "purchase."

Section 338(h)(3)(A) defines "purchase" as any acquisition of stock, but only if - (i) the basis of the stock in the hands of the purchasing corporation is not determined (I) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, or (II) under section 1014(a) (relating to property acquired

from a decedent), (ii) the stock is not acquired in an exchange to which, or sections 351, 354, 355, or 356 applies and is not acquired in any other transaction described in regulations in which the transferor does not recognize the entire amount of the gain or loss realized on the transaction, and (iii) the stock is not acquired from a person the ownership of whose stock would under section 318(a) (other than paragraph (4) thereof), be attributed to the person acquiring such stock.

The transfer of X stock to Newco satisfies all three statutory requirements for a "purchase." FIRST, the basis of the X stock in the hands of Newco is not determined in whole or in part by reference to the adjusted basis of the stock in the hands of the transferors. For instance, section 351 will not apply to the transfer of X stock to Newco. This is so because pursuant to the terms of the Underwriting Agreement, Family, Y and PRS2 will be bound to sell, immediately after the Closing, a substantial portion of the Newco common stock they receive in such transaction to third parties who will not have also transferred property to Newco. As a result of and after such transfer, Family, Y, PRS2, PRS7, and T will own, in the aggregate, substantially less than 80 percent of the vote and value of Newco. Accordingly, Family, Y, PRS2, PRS7, and T will not have the requisite stock ownership needed to be considered in "control" of Newco immediately after the proposed transaction.

Moreover, the transfer of X stock to Newco will not qualify as a section 368 tax-free reorganization. The transfer cannot qualify as a section 368(a)(1)(B) reorganization because the acquisition by Newco of the X stock will not be solely for voting stock of Newco. See Chairman v. Commissioner, 618 F.2d 856 (1st Cir. 1980) (no cash is permissible in a reorganization described in section 368(a)(1)(B), cert. dismissed, 451 U.S. 1012; Rev. Rul. 75-123, 1975-1 C.B. 115 (acquisition of 80 percent of Target for stock and 20 percent for cash pursuant to the same plan violates "solely for voting stock" requirement of section 368(a)(1)(B)). Last, the transfer of the X stock to Newco will not qualify under any other section 368 reorganization provision because X will not be liquidated or merged into Newco or any affiliate of Newco.

Furthermore, section 304, which provides for a carryover basis in certain situations, also does not apply to this transaction. Newco will not be a commonly controlled corporation because more than 50 percent of its stock will be owned by the public. Even if section 304 were applicable to the cash paid by Newco in the transaction, the X stock acquired for such cash would be treated as purchased for purposes of section 338 because section 302(a) would apply to the receipt by Family and PRS2 of such cash. See H.R. Rep. No. 99-426, at 1021 (1985) (contribution to capital rule will not apply if the shareholder is treated as having exchanged its stock (under section 302(a)); thus, where section 302(a) applies, the acquiring corporation will be treated as purchasing the stock, for example, for purposes of section 338). That is, even if section 304 applied to Newco's acquisition of the X stock, Family's transfer of X stock would be treated as a sale by Family and a cost basis purchase by Newco and not as a dividend to Family and carryover basis acquisition by Newco. See Zenz v. Ouinlivan, 213 F.2d 914 (6th Cir. 1954) (the purchase by a corporation of its stock from a shareholder (when coupled with the sale by the shareholder of the remainder of her stock to a competitor) was not a dividend to the selling shareholder and the proceeds

must be treated as payment in exchange for the stock surrendered) and Rev. Rul. 75-447, 1975-2 C.B. 113 (the sequence of events will be disregarded and effect will be given only to the overall result in determining whether a distribution is "substantially disproportionate" in plans calling for a stock redemption accompanied either by an issuance of new stock or by a shareholder's sale of stock if the events are clearly part of an overall integrated plan to reduce a shareholder's interest). Finally, section 304 cannot apply to the acquisition by Newco of over 80 percent by vote and value of the outstanding stock of X in exchange for Newco stock because such stock is not "property" for purposes of section 304. See section 317(a).

As a result, the transfer of the X stock to Newco will be a taxable transaction and Newco's basis in the X stock will be its cost for such stock, i.e., the sum of the fair market value of the Newco shares which are exchanged plus the cash paid by Newco. See section 1012 and section 1.1032-1(d).

SECOND, the X stock will not be acquired by Newco in an exchange to which sections 351, 354, 355, or 356 apply and will not be acquired in any other transaction described in regulations in which the transferors do not recognize the entire amount of the gain or loss realized on the transaction. As discussed above, neither section 351 nor section 368 apply to the transfer. No other non-recognition provisions apply and, as a result, the transferors will recognize the entire amount of their gain or loss on the X stock transferred to Newco.

THIRD, Newco will not acquire the X shares from a person whose ownership of stock would be attributable to Newco under section 318(a). Newco would be treated as owning the stock held by the transferors of the X stock only if the transferors are treated as owning 50 percent or more of the value of the stock of Newco. See section 318(a)(3)(C). The proper time for testing whether a relationship exists under section 318(a) is AFTER the transaction in which the acquiring corporation obtains the target stock. In the instant case, immediately after the SPO, Family will own (directly and by section 318 attribution) significantly less than 50 percent of the stock of Newco because of Family's binding commitment to sell a significant portion of their Newco stock. As a result, Newco will not be treated as acquiring the X shares from a person whose ownership of stock would be attributable to Newco under section 318(a).

Accordingly, the acquisition of X by Newco will qualify as a "purchase" within the meaning of section 338(h)(3)(A), and all of the requirements of a QSP will be satisfied with respect to Newco's acquisition of X.

CONCLUSION

Based on the information submitted and the representations made, we have reached four [sic] conclusions requested by X, Family, and Newco. These conclusions are as follows:

(1) The PPA is not an unrealized receivable for purposes of section 751(a)(1);

(2) The PPA is not an inventory item for purposes of section 751(a)(2);

(3) The acquisition of the X stock by Newco will be a "qualified stock purchase" ("QSP") within the meaning of section 338(d)(3); and

(4) Family and Newco are entitled to make an election under section 338(h)(10).

(5) The transfer of 100 percent of the outstanding stock of X by Family to Newco and the deemed sale of X's assets is not a sale or exchange of property, directly or indirectly, between related persons for purposes of section 1239(a).

Except as held immediately above, no opinion is rendered regarding the federal income tax effects of any of the transactions described above under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter have not yet been adopted. Therefore, the Service may modify or revoke this letter if temporary or final regulations as adopted are inconsistent with any conclusions herein. See section 11.04 of Rev. Proc. 98-1, 1998-1 I.R.B. 7, 47. However, when the criteria in section 11.05 of Rev. Proc. 98-1 are satisfied, the Service will not revoke or retroactively modify a ruling except in rare or unusual circumstances.

Determination of the taxpayer's liability will be made by the District Director when examining the taxpayer's return. The District Director will consider whether the conclusions stated in the ruling letter are properly reflected in the return, whether the representations upon which the ruling letter was based reflected an accurate statement of the material facts, whether the transaction was carried out substantially as proposed, and whether there has been any change in the law or regulations which applies to the period during which the transaction was consummated.

This ruling is directed only to the taxpayers who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

DIANNA K. MIOSI
Branch Chief, Branch 1

Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure: Copy of this letter
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Cc: