Internal Revenue Service

Number: **200827018**
Release Date: 7/4/2008

Index Number: 1042.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EB:QP2
PLR-141501-07

Date:
March 13, 2008

TY: 52-53 week fiscal year ending on the last in

Legend

A =

B =

Trust A =

Trust B =

X =

Y =

Z =

Date D =

Dear :

This responds to your letter dated September 14, 2007, requesting a ruling under section 1042 of the Internal Revenue Code (Code) submitted on behalf of Z and the Shareholders of Z (collectively, the Taxpayers) by your authorized representative.

Originally, X was organized as a corporation by individuals A and B in 1987. A and B held and respectively, of the stock of X. X was taxed as a C corporation for the taxable years 1987 through 1998. In of 1998, A transferred his shares to Trust A. The Taxpayers represent that Trust A is a grantor trust pursuant to section 676 of the Code. Beginning in 1999, X made an election under section 1362(a) to be taxed as an S corporation pursuant to section 1362(a) of the Code. Also in 1999, B

transferred his shares in X to grantor Trust B. The Taxpayers represent that Trust B is a grantor trust pursuant to section 676 of the Code. Effective at the beginning of 2002, X revoked its S corporation election pursuant to section 1362(d)(1) with the consent of Trusts A and B (the Shareholders).

In 2004, the Shareholders reorganized X. Y, a limited liability company, was created. Y elected to be classified as an association taxable as a corporation for federal tax purposes. X was merged with and into Y with Y as the surviving entity. Y had only one class of membership interests outstanding. The Shareholders received interests in Y in the same proportions as the ownership of the shares of common stock in X. Y had no assets other than the assets it acquired from X during the merger. The transaction was treated as a reorganization within the meaning of section 368(a)(1)(F) of the Code. The Shareholders did not recognize gain or loss on the exchange of their stock in X for membership interests in Y pursuant to section 354.

On Date D, 2007, as part of a second reorganization, Y created Z, a wholly-owned corporation. Thereafter, Y was merged into Z with Z surviving. The Shareholders received shares of stock in Z in the same proportions as the ownership of their membership interests in Y. The Taxpayers treated the transaction as a reorganization with the meaning of section 368(a)(1)(F) of the Code. The Shareholders did not recognize gain or loss on the exchange of their membership interests in Y for stock in Z pursuant to section 354. The basis of the Shareholders' stock was the same as the basis of their membership interests in Y prior to the reorganization pursuant to section 358(a).

Z is a domestic C corporation with one class of stock issued and outstanding. Z's stock is not readily tradable on an established securities market. At all times since 1987, the stock of Z (or its predecessors) has been owned by the Shareholders or the individuals A and B.

Z proposes to establish an employee stock ownership plan (ESOP) meeting the requirements of section 4975(e)(7) of the Code. The ESOP will purchase at least 30 percent of the outstanding stock of Z from the Shareholders. Z and the Shareholders represent that the transaction would satisfy the requirements of section 1042 and section 1.1042-2T of the Income Tax Regulations.

The Taxpayers have requested a ruling that the Shareholders' holding period in Z stock for purposes of section 1042(b)(4) of the Code will include the holding period of the Shareholders in their membership interests in Y.

Section 1042(a) of the Code provides that a taxpayer or executor may elect in certain cases not to recognize long-term capital gain on the sale of "qualified securities" to an ESOP (as defined in section 4975(e)(7)) or eligible worker owned cooperative if the taxpayer purchases "qualified replacement property" (as defined in section 1042(c)(4))

within the replacement period of section 1042(c)(3) and the requirements of section 1042(b) and section 1.1042-1T of the Income Tax Regulations (the regulations) are satisfied.

A sale of “qualified securities” meets the requirements of section 1042(b) of the Code if: (1) the qualified securities are sold to an ESOP (as defined in section 4975(e)(7), or an eligible worker owned cooperative; (2) the plan or cooperative owns (after application of 318(a)(4)), immediately after the sale, at least 30 percent of - a) each class of outstanding stock of the corporation (other than stock described in section 1504(a)(4)) which issued the securities, or (b) the total value of all outstanding stock of the corporation (other than stock described in section 1504(a)(4)); (3) the taxpayer files with the Secretary a verified written statement of the employer whose employees are covered by the ESOP or an authorized officer of the cooperative consenting to the application of section 4978 and 4979A with respect to such employer or cooperative; and (4) the taxpayer's holding period with respect to the qualified securities is at least 3 years (determined as of the time of the sale) under section 1042(b)(4).

For taxable years beginning after December 31, 1997, section 1042(c)(1) of the Code provides that the term “qualified securities” means employer securities (as defined in section 409(l)) which are issued by a domestic C corporation that has no stock outstanding that is readily tradable on an established securities market; and were not received by the taxpayer in a distribution from a plan described in section 401(a), or in a transfer pursuant to an option or other right to acquire stock to which section 83, 422 or 423 applied.

Section 409(l)(1) of the Code provides that “employer securities” means common stock issued by the employer (or by a corporation which is a member of the same controlled group) which is readily tradable on an established securities market. Section 409(l)(2) provides that if there is no common stock which meets the requirements of section 409(l)(1), “employer securities” means common stock issued by the employer (or by a corporation which is a member of the same controlled group) having a combination of voting power and dividend rights equal to or in excess of: i) that class of common stock of the employer (or of any other such corporation) having the greatest voting power, or ii) that class of common stock of the employer (or of any other such corporation) having the greatest dividend rights.

With respect to the present ruling request, Z has only one class of common stock outstanding. Z has no stock outstanding that is readily tradable on an established securities market. The Shareholders did not receive their shares of Z stock in a distribution from a plan described in section 401(a) of the Code or a transfer pursuant to an option or other right to acquire stock to which section 83, 422, or 423 applied.

Therefore, based on the specific facts of this case and representations made by Z and the Shareholders, and provided (1) that the ESOP is qualified under section 401(a) of

the Code and meets the requirements of section 4975(e)(7), and (2) that the Date D, 2007, reorganization satisfied the requirements of section 368(a)(1)(F), we conclude that that the Shareholders' holding period in Z stock for purposes of section 1042(b)(4) will include the holding period of the Shareholders in their membership interests in Y.

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. No opinion is expressed or implied as to whether the transaction of Date D, 2007, qualified as a reorganization under section 368(a)(1)(F) of the Code.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayers 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 taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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,

John T. Ricotta
Chief, Qualified Plans Branch 2
Office of Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)

Enclosure:
Copy for 6110 purposes