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Corporation X =

Corporation Y =

Business J =

Business K =

A =

B =

C =

D =

E =

F =

State G =

State H =

Date 1 =

n =

This is in response to a letter dated October 9, 1998, in which a ruling is requested as to the federal income tax consequences of a proposed transaction. The information submitted is summarized below.

The taxpayer, Corporation X, is a State G corporation engaged in Business J. It has a taxable year ending April 30th and uses a cash method of accounting. Corporation X has one class of voting common stock outstanding. It has incurred substantial net operating losses in prior taxable years.

Corporation Y is a State H corporation engaged in Business K. It is a calendar year taxpayer and uses an accrual method of accounting. Corporation Y has outstanding two classes of stock, which are voting common stock and non-voting common stock.

Corporation X has three shareholders -- A, B, and E. A and B are married, and E is B's sibling. Prior to Date 1, which is within the "testing period" as defined in § 1.382-2T(d) of the temporary Income Tax Regulations, the shareholders of Corporation X were A and B. On Date 1, A and B sold a portion of their shares of Corporation X to E (the "Sale"). The taxpayer represents that the Sale did not result in an "ownership change" as defined in § 382(g)(1) of the Internal Revenue Code (the "Code").

The shareholders of Corporation Y are C, D, E, and F. B, D, and E are siblings and C is their father; F is E's daughter. Although some of the Corporation Y shareholders hold all or part of their Corporation Y shares in trusts, it has been represented that these shareholders are considered to be the owners of such shares pursuant to § 318(a)(2)(B)(ii) and subpart E of part I of subchapter J of the Code. To achieve efficiencies of operation with respect to the business activities of Corporation X and Corporation Y, the taxpayer proposes to merge Corporation X with and into Corporation Y pursuant to the laws of State H (the "Merger"). The taxpayer represents that the Merger will qualify as a reorganization described in § 368(a)(1)(A).

Section 1.382-2T(h)(6)(ii) provides that "an individual and all members of his family described in § 318(a)(1) shall be treated as one individual." This provision remains applicable to the Merger despite § 1.382-2T(h)(6)(iii) (which limits application of the one individual rule as to a family member who does not actually own five percent of the corporation's stock) because of the corporations' actual knowledge of the relationship existing between A, B, C, D, E and F. See § 1.382-2T(k)(2).

Pursuant to § 318(a)(1), there are ten families involved in the proposed transaction. C and each of his children individually, C and his children collectively, and C together with his children and his granddaughter all constitute families, making five families. The remaining five families are (1) C and his children and his daughter's husband, (2) B and her husband, (3) E and his daughter, (4) C and his daughter and

her husband, and (5) C with his children, his daughter's husband, and his granddaughter. Each of these families is treated as one individual who is a 5-percent shareholder. See § 1.382-2T(h)(6)(ii). Section 1.382-2T(h)(6)(iv) provides that "if an individual may be treated as a member of more than one family, and each family that is treated as one individual is a 5-percent shareholder . . . then such individual shall be treated only as a member of the family that results in the smallest increase in the total percentage stock ownership of the 5-percent shareholders on the testing date and shall not be treated as the member of any other family." Among the families described above, the family that will result in the smallest increase in the total percentage stock ownership of the 5-percent shareholders on the date of the Merger is C together with his children and his granddaughter -- that is, B, C, D, E, and F (the "Family").

Before the Sale on Date 1, the Family owned 50% of Corporation X's stock. After the Merger, the Family will own n% of the Corporation Y's stock. Consequently the Family's ownership of Corporation Y will have increased by less than 50 percentage points over their ownership of Corporation X before the Sale.

Since the Sale on Date 1, the Family has owned more than 50% of Corporation X's stock. After the Merger, the Family's ownership of Corporation Y will have increased by less than 50 percentage points over their ownership of Corporation X after the Sale but prior to the Merger.

Based solely on the information and representations submitted, we rule as follows:

(1) The Merger will not result in an ownership change as defined in § 382(g)(1).

(2) Based on ruling (1), the net operating losses of Corporation X available to offset the post-Merger taxable income of Corporation Y will not be limited as a result of the Merger.

No opinion is expressed as to the tax treatment of the transaction under other provisions of the Code and 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. We specifically express no opinion as to (1) whether the Sale resulted in an ownership change, (2) whether the Merger will qualify as a reorganization under § 368 (a)(1)(A), or (3) whether shareholders of Corporation Y who hold shares in trusts are considered to be the owners of such shares pursuant to § 382(a)(2)(B)(ii) and subpart E of part I of subchapter J of the Code.

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

A copy of this ruling should be attached to the applicable federal income tax

return of the taxpayer.

In accordance with the power of attorney on file in this office, a copy of this ruling is being sent to your authorized representative.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Michael J. Wilder
Michael J. Wilder
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