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Department of the Treasury

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Person to Contact:

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Date:
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Target =

Acquiring =

Acquiring Parent =

State X =

A =

B =

business m =

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This letter responds to your request dated September 10, 1998, for rulings as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated December 7, 1998, December 29, 1998, January 14, 1999, and February 18, 1999. The information submitted is summarized below.

Acquiring, a State X corporation, is a national bank engaged in the commercial banking business. Acquiring has a single class of common stock outstanding, which is wholly owned by Acquiring Parent, also a State X corporation. Acquiring Parent is a bank holding company. Acquiring Parent is widely held and publicly traded, and has a class of voting stock and a class of preferred stock outstanding.

Target, also a State X corporation, is engaged primarily in business m. Target has a single class of common stock outstanding, n% of which is held by A and the remaining o% of which is held by B. The liabilities of Target include its obligations under a Target note held by B (the "Note"), which has been represented to constitute debt of Target.

For what have been represented to be valid business reasons, the parties propose the following transaction:

(1) Target will transfer substantially all of its assets to Acquiring in exchange for shares of Acquiring Parent's voting common stock (the "Acquiring Parent stock") and Acquiring's assumption (or payment at closing) of certain Target liabilities (including the Note).

(2) Target will distribute, in complete liquidation, the Acquiring Parent stock and any retained assets and liabilities of Target to A and B in proportion to their respective ownership of Target stock.

(3) Approximately p % of the Acquiring Parent stock to be received by A and B will be placed in escrow for two years. A and B will have the right to receive q% of the escrowed stock on the first anniversary of the closing date and r% of the escrowed stock on the second anniversary of the closing date, provided certain performance goals are met with respect to the transferred Target assets in the hands of Acquiring. A and B will have voting rights and the right to receive dividends with respect to the shares held in escrow. The rights of A and B to the escrowed stock will be nontransferable. A will become an employee of Acquiring.

The taxpayers have made the following representations in connection with the transaction:

(a) The fair market value of the Acquiring Parent stock to be received by each Target shareholder will be approximately equal to the fair market value of the Target stock surrendered in the exchange.

(b) (1) During the five year period beginning on the date of the proposed transaction, there is no plan or intention by Acquiring, Acquiring Parent, or any person related to Acquiring (as defined in § 1.368-1(e)(3) of the Income Tax Regulations) to acquire or redeem any of the Acquiring Parent stock issued in the transaction either directly or through any transaction, agreement, or arrangement with any other person, except for escrowed shares, if any, which may revert to Acquiring Parent pursuant to the escrow arrangement. Assuming that all of the escrowed shares revert to Acquiring Parent pursuant to the escrow arrangement, the distribution described in paragraph (2) below will not exceed fifty percent of the value (without giving effect to such distribution) of the proprietary interest in Target.

(2) During the five year period ending on the date of the proposed transaction, neither Target nor any person related to Target (as defined in § 1.368-1(e)(3) without regard to § 1.368-1(e)(3)(i)(A)) will have directly or through any transaction, agreement or arrangement with any other person, (i) acquired stock of Target with consideration other than shares of Acquiring Parent or Target, or (ii) made distributions with respect to Target stock, except for the distribution of any retained assets of Target to its shareholders in the transaction which will, assuming that all of the escrowed shares revert to Acquiring Parent pursuant to the escrow arrangement, not exceed 50 percent of the value (without giving effect to such distribution) of the proprietary interest in Target.

(3) Prior to or in the transaction, neither Acquiring Parent, Acquiring, or any person related to Acquiring (as defined in § 1.368(e)(3)) will have acquired directly or through any transaction, agreement or arrangement with any other person, stock of Target with consideration other than shares of Acquiring Parent.

(c) Acquiring will acquire at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Target immediately prior to the transaction. For purposes of this representation, amounts used by Target to pay its reorganization expenses, amounts paid by Target to shareholders who receive cash or other property, and all redemptions and distributions (except for regular, normal dividends) made by Target immediately preceding the transfer will be included as assets of Target held immediately prior to the transaction.

(d) Acquiring has no plan or intention to reacquire any of its Acquiring Parent stock issued in the transaction other than in the ordinary course of its business.

(e) Acquiring has no plan or intention to sell or otherwise dispose of any of the assets of Target acquired in the transaction, except for dispositions made in the ordinary course of business.

(f) Target will distribute the stock of Acquiring Parent it receives in the transaction, and its other retained properties, in pursuance of the plan of reorganization.

(g) The liabilities of Target assumed by Acquiring and the liabilities to which the transferred assets are subject were incurred by Target in the ordinary course of its business.

(h) Following the transaction, Acquiring will continue the historic business of Target or use a significant portion of Target's historic business assets in a business.

(i) Acquiring, Target, and the shareholders of Target will pay their respective expenses, if any, incurred in connection with the transaction.

(j) There is no intercorporate indebtedness existing between Acquiring and Target that was issued, acquired, or will be settled at a discount.

(k) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv) of the Internal Revenue Code.

(l) Acquiring does not own, directly or indirectly, nor has it owned during the past five years, directly or indirectly, any stock of Target.

(m) The fair market value of the assets of Target transferred to Acquiring will equal or exceed the sum of the liabilities assumed or paid at closing by Acquiring, plus the amount of liabilities, if any, to which the transferred assets are subject.

(n) Target is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

(o) To the extent that a portion of the shares of stock issued in exchange for the requisite stock or property will be placed in escrow by the exchanging shareholders and will be made subject to a condition pursuant to the escrow arrangement, for possible return to the issuing corporation under specified conditions: (1) there is a valid business reason for establishing the escrow arrangement; (2) the shares of stock subject to the escrow arrangement will appear as issued and outstanding on the balance sheet of Acquiring Parent and such shares will be legally outstanding under applicable state law; (3) all dividends paid on such shares will be distributed to the exchanging shareholders; (4) all voting rights of such stock will be exercisable by or on

behalf of the exchanging shareholders or their authorized agent; (5) no such shares will be subject to restrictions requiring their return to Acquiring Parent because of death, failure to continue employment or similar restrictions; (6) all such shares will be released from the escrow arrangement within five years from the date of consummation of the transaction (except where there is a bona fide dispute as to whom the stock should be released); (7) at least 50 percent of the number of shares of stock issued initially to the exchanging shareholders will not be subject to the escrow arrangement; (8) the return of such shares will not be triggered by an event the occurrence or nonoccurrence of which is within the control of the exchanging shareholders; (9) the return of such shares will not be triggered by the payment of additional tax or reduction in tax paid as a result of a Service audit of the exchanging shareholders, Acquiring, or Acquiring Parent either (a) with respect to the transaction in which such shares will be issued, or (b) when the transaction in which such shares will be issued involves person related within the meaning of § 267(c)(4); and (10) the mechanism for the calculation of the number of shares of Acquiring Parent stock to be returned is objective and readily ascertainable.

(p) Compensation paid by Acquiring to A after the transaction will be for services actually rendered, will be commensurate with amounts paid to third parties bargaining at arm's length for similar services, and will not be separate consideration for, or allocable to, any of A's shares of Target stock. In addition, none of the shares of Acquiring Parent stock to be received by A in the transaction will be separate consideration for, or allocable to, any employment agreement.

(q) The amount that will be paid to B at closing in satisfaction of the Note will not exceed the fair market value of the Note.

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

(1) The acquisition by Acquiring of substantially all of the assets of Target solely in exchange for Acquiring Parent stock and the assumption by Acquiring of certain liabilities of Target, followed by the distribution by Target of the Acquiring Parent stock and any retained assets to its shareholders in complete liquidation, will constitute a "reorganization" within the meaning of § 368(a)(1)(C). For purposes of this ruling, "substantially all" means at least 90% of the fair market value of the net assets and at least 70% of the fair market value of the gross assets of Target. Acquiring Parent, Acquiring, and Target will each be a "party to a reorganization" within the meaning of § 368(b).

(2) Target will recognize no gain or loss on the transfer of substantially all of its assets to Acquiring solely in exchange for Acquiring Parent stock and the

assumption (or payment at closing) by Acquiring of certain Target liabilities or on the distribution of such Acquiring Parent stock to Target shareholders (§§ 361(a) and (c), 357(a)). Target will recognize gain upon the distribution of appreciated property, if any, to its shareholders as if such property was sold at its fair market value (§ 361(c)(2)(A)).

(3) Acquiring will recognize no gain or loss on the receipt of substantially all of Target's assets solely in exchange for shares of Acquiring Parent stock (§ 1.1032-2).

(4) The basis of the assets of Target in the hands of Acquiring will be the same as the basis of those assets in the hands of Target immediately prior to the transaction (§ 362(b)).

(5) Acquiring's holding period for the assets received in the transaction will include the period during which those assets were held by Target (§ 1223(2)).

(6) The Target shareholders will recognize no gain or loss on the receipt of Acquiring Parent stock solely in exchange for Target stock (§ 354(a)(1)).

(7) The gain, if any realized by a Target shareholder upon receipt of Acquiring Parent stock and cash or other property, in exchange for Target stock, will be recognized, but in an amount not in excess of the cash and other property received (§356(a)(1)). If the exchange has the effect of a distribution of a dividend (determined with the application of § 318 (a)), then the amount of the gain recognized that is not in excess of the shareholder's ratable share of the undistributed earnings and profits will be treated as a dividend (§ 356(a)(2)). The determination of whether the exchange has the effect of a distrubution of a dividend will be made in accordance with the principles set forth in Commissioner v. Clark, 489 U.S. 726 (1989). No loss will be recognized by a Target shareholder pursuant to § 356(c).

(8) The basis of the Acquiring Parent stock received by the Target shareholders (including the escrowed shares) will, in each instance, be the same as the basis of the Target stock surrendered in exchange therefor, decreased by the amount of money and other property received by the Target shareholders and increased by the amount, if any, which was treated as a dividend, and the amount of gain (not including any portion of such gain which was treated as a dividend, if any) the Target shareholders may have recognized on such exchange (§ 358(a)(1)). Upon a return of any portion of the escrowed shares to Acquiring, the adjusted basis of the portion of the escrowed shares returned will be added to the adjusted basis of the remaining shares of Acquiring stock received by Target

shareholders in the reorganization (Rev. Rul. 76-42, 1976-1 C.B. 102).

(9) The holding period of the Acquiring Parent stock received by the Target shareholders (including the escrowed shares) will include the period that the shareholders held the Target stock surrendered in exchange therefor, provided the Target stock was held as a capital asset on the date of the exchange (§ 1223(1)).

(10) Pursuant to § 381(a) and § 1.381(a)-1, Acquiring will succeed to and take into account the items of Target described in § 381(c), including the earnings and profits, or deficit in earnings and profits, of Target as of the date of transfer. Any deficit in the earnings and profits of Acquiring or Target will be used only to offset the earnings and profits accumulated after the date of transfer. These items will be taken into account by Acquiring subject to the conditions and limitations specified in §§ 381, 382, 383, and 384 and the regulations thereunder.

No opinion is expressed about the tax treatment of the proposed 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 proposed transaction that are not specifically covered by the above rulings. We specifically express no opinion regarding (1) the tax treatment of the Note, including whether or not the Note represents debt or equity, and (2) whether interest will be imputed pursuant to § 483 as a result of any release from escrow of shares of Acquiring Parent to the Target shareholders.

This ruling letter is directed only to the taxpayers who requested it. Section 6110(k)(3) 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 returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to the taxpayers' authorized representative.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Michael J. Wilder
Michael J. Wilder
Assistant to the Chief, Branch 3