

Internal Revenue Service

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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:PSI:B03
PLR-147717-12

Date:
April 03, 2013

LEGEND

X =

State =

A =

B =

Date 1 =

Date 2 =

a

b

c

d

e

f

Dear _____ :

This letter responds to a letter dated November 1, 2012, and subsequent correspondence, submitted on X's behalf by its authorized representative, requesting certain rulings with respect to the proposed redemption of X stock.

FACTS

X was incorporated in State on Date 1. X elected to be treated as a subchapter S corporation effective Date 2. Prior to Date 2, X was taxed as a subchapter C corporation. At the time of the proposed redemption, X will have accumulated earnings and profits. X represents it does not have more than one class of stock.

A directly owns a shares of voting stock and b shares of non-voting stock in X. A represents that A is treated as the owner of B pursuant to §§ 671 and 675(4)(C), and is therefore treated as owning for federal income tax purposes an additional c shares of non-voting stock in X. As such, A owns, either directly or constructively pursuant to attribution rules under § 318(a)(2)(B)(ii), d% of the voting shares and e% of the non-voting shares of X. After the redemption, A will still own d% of the voting shares and will continue to own directly and indirectly through B e% of the non-voting shares.

X proposes to redeem for cash shares of A's non-voting stock equal in value to f. X represents that the aggregate amount of the redemption will not exceed X's accumulated adjustments account as defined by § 1368(e)(1). X also represents that the proceeds from the redemption will be based on the fair market value of the stock at the time of the redemption, as determined by a qualified appraisal.

X further represents that:

1. There are no outstanding options or warrants to purchase X stock, nor are there any outstanding debentures or other obligations that are convertible into X stock or would be considered X stock.
2. No shareholder of X has been or will be obligated to purchase any of the stock to be redeemed.
3. The redemption is an isolated transaction and is not related to any past or future transactions.
4. X has no plan or intention to issue, redeem, or exchange additional shares of its stock.

X requests the following rulings:

1. That the redemption of A's non-voting X stock will (except as provided in § 1368) be treated as a distribution of property to which § 301 applies;
2. That the distributions from X for the redemption will not be included in the gross income of A to the extent the total distributions by X during the taxable year do not exceed the amount in X's accumulated adjustments account at the close of the taxable year and to the extent that the distributions do not exceed A's adjusted basis in A's X stock after taking into account the adjustments described in § 1367; and
3. That the redemption will not create a second class of stock under § 1361(b)(1)(D), and, thus, will not terminate X's subchapter S election.

LAW

Section 1371(a)(1) provides that, except to the extent otherwise provided in Title 26, and except to the extent inconsistent with subchapter S, subchapter C applies to an S corporation and its shareholders.

Section 302(d) provides that, if a stock redemption does not qualify under § 302(a), it will be treated as a distribution to which § 301 applies. Under § 302(a), a stock redemption is treated as an exchange if the redemption: (1) is "not essentially equivalent to a dividend" under § 302(b)(1); (2) is substantially disproportionate under § 302(b)(2); (3) is in complete redemption of the shareholder's interest under § 302(b)(3); (4) is a partial liquidation under § 302(b)(4); or (5) is by certain regulated investment companies under § 305(b)(5).

Section 301(a) generally treats a distribution of property in the manner provided under § 301(c). Section 1368(a), except to the extent provided in § 1368, overrides § 301(c).

Section 1368(a) provides that a distribution of property made by an S corporation with respect to its stock to which (but for § 1368(a)) § 301(c) would apply is treated in the manner provided in § 1368(b) or (c), whichever applies.

Section 1368(b)(1) provides that, in the case of a distribution described in § 1368(a) by an S corporation which has no accumulated earnings and profits, the distribution shall not be included in gross income to the extent that it does not exceed the adjusted basis of the stock.

Section 1368(c)(1) provides that, in the case of a distribution described in § 1368(a) by an S corporation which has accumulated earnings and profits, that portion of the distribution which does not exceed the accumulated adjustments account shall be treated in a manner provided by § 1368(b).

Section 1368(d) provides that § 1368(b) and (c) are applied by taking into account (to the extent proper): (1) the adjustments to the basis of the shareholder's stock described in § 1367, and (2) the adjustments to the accumulated adjustments account that are required by § 1368(e)(1).

Rev. Rul. 95-14, 1995-1 C.B. 169, holds that when an S corporation shareholder receives proceeds in a redemption that is characterized as a distribution under § 301, the entire redemption is treated as a distribution for purposes of § 1368 that reduces the corporation's accumulated adjustments account.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to the taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year. Section 1361(b)(1)(D) provides that the term "small business corporation" means a domestic corporation that, among other things, does not have more than one class of stock. Accordingly, S corporations may not have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation that has more than one class of stock does not qualify as a small business corporation. Except as provided in § 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements governing distribution and liquidation proceeds (collectively, the governing agreements).

Section 1.1361-1(l)(2)(iii)(A) provides that buy-sell agreements among shareholders, agreements restricting the transferability of stock, and redemption agreements are disregarded in determining whether a corporation's outstanding shares of stock confer identical distribution and liquidation rights unless: (1) a principal purpose of the agreement is to circumvent the one class of stock requirement of § 1361(b)(1)(D), and (2) the agreement establishes a purchase price that, at the time the agreement is entered into, is significantly in excess of or below the fair market value of the stock.

Agreements that provide for the purchase or redemption of stock at book value or at a price between fair market value and book value are not considered to establish a price that is significantly in excess of or below the fair market value of the stock and, thus, are disregarded in determining whether the outstanding shares of stock confer identical rights. For purposes of § 1.1361-1(l)(2)(iii)(A), a good faith determination of fair market value will be respected unless it can be shown that the value was substantially in error and the determination of the value was not performed with reasonable diligence.

CONCLUSION

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

1. The redemption of A's shares of non-voting stock in X does not qualify as a distribution of property in exchange for X stock under § 302(b)(1), (2), (3), (4), or (5); therefore, under § 302(d), the redemption of A's non-voting X stock will (except as provided in § 1368) be treated as a distribution of property to which § 301 applies.
2. The distributions from X for the redemption will not be included in the gross income of A to the extent the total distributions by X during the taxable year do not exceed the amount in X's accumulated adjustments account at the close of the taxable year and also do not exceed the adjusted basis of A in A's X stock after taking into account the adjustments described in § 1367.
3. The redemption will not create a second class of stock under § 1361(b)(1)(D) that would cause the termination of X's subchapter S election.

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. Specifically, no opinion is expressed regarding whether X was or is otherwise eligible to be treated as an S corporation.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer 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 ruling request, it is subject to verification on examination.

Sincerely,

/s/

Richard T. Probst
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes

cc: