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Person To Contact:

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Date:
October 06, 2014

LEGEND:

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

A =

B =

a =

b =

Redemption Plan =

Dear

This responds to a letter dated March 28, 2014, submitted on behalf of X by its authorized representative, requesting a ruling under § 1361(b)(1)(D) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated on Date 1 in State and elected to be treated as an S corporation effective Date 2. Prior to Date 3, X had one class of stock outstanding and all shares of X stock had identical voting, distribution and liquidation rights. X's stock is owned equally between A and A's family and B and B's family. On Date 3, X amended its Articles of Incorporation in order to create non-voting common stock. On Date 4, X declared and issued a dividend of a shares of non-voting common stock per each share of X's voting common stock. X represents that all of the stock confers identical rights to distributions and liquidation proceeds.

X proposes to adopt a stock redemption plan ("Redemption Plan"). The Redemption Plan is voluntary at the discretion of the X shareholders on an annual basis and capped at a specific cash limit. The Redemption Plan provides that any shareholder who desires to have his X stock redeemed must have his non-voting and voting shares redeemed in the ratio of a (non-voting) to b (voting) unless the Board of Directors in its discretion approves the stock redemption in a different ratio. X represents that this redemption ratio in the Redemption Plan is to ensure that X's voting power and economic ownership between A and A's family and B and B's family remain approximately equal and to prevent an individual shareholder from owning a disproportionate amount of voting versus nonvoting common stock. X represents that the redemption price for the stock is the appraised value of the voting and nonvoting common stock (on a minority basis) as shown on the most recent independent appraisal but if no independent appraisal has been made within a certain time frame of the redemption, the Board of Directors can determine in good faith the value, which is intended to be based upon the methodology used by the independent appraisal.

X represents that the Redemption Plan is not designed or intended to circumvent or otherwise violate the second class of stock rule of § 1.1361-1(l)(2)(iii)(A). X also represents that the Redemption Plan does not establish a purchase price for the stock that, at the time the agreement is entered into, is significantly in excess of or below the fair market value of the stock.

Law and Analysis

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)(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 facts submitted and the representations made, we conclude that the Redemption Plan described above will be disregarded in determining whether the outstanding shares of X stock confer identical distribution and liquidation rights and will not cause X to be treated as having a second class of stock within the meaning of § 1361(b)(1)(D).

Except as specifically set forth above, we express or imply no opinion as to the federal tax consequences of the above facts under any other provision of the Code. Specifically, we express or imply no opinion concerning whether X's S corporation election is valid under § 1362.

This ruling is directed only to the taxpayer who requested 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 X's authorized representative.

Sincerely,

Joy C. Spies

Joy C. Spies

Senior Technician Reviewer, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: