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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-123691-18
Date:
November 16, 2018

LEGEND:

X =

State =

Date 1 =

Date 2 =

Agreement =

Plan =

Dear :

This letter responds to a letter dated August 2, 2018, and subsequent correspondence, submitted on behalf of X requesting a ruling under § 1361(b)(1)(D) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on Date 1, and elected to be treated as an S corporation effective Date 2. X has one class of voting common stock outstanding.

Under an agreement entered into by X and its shareholders, the Agreement, shares generally may not be transferred without the prior written consent of the Chairman of the Board of Directors of X.

X has adopted an equity compensation plan, the Plan, which authorizes X to sell shares of X's stock to key employees of X or to grant shares or options to purchase shares to such employees. Shares acquired under the Plan are subject to the same transfer restrictions set forth in the Agreement. In addition, shares held by employees may be repurchased under certain circumstances by X (generally, upon termination of employment) at either the "non-forfeiture repurchase price," which equals the fair market value of the shares, or the "forfeiture repurchase price," which is the lesser of: (i) the fair market value of the shares or (ii) the price paid, if any, to acquire the shares. Depending on the circumstances, the forfeiture repurchase price could be as low as zero. The repurchase price of the shares will only be the forfeiture repurchase price if the employee has engaged in activity meeting the definition of "cause" in the Plan, which generally only includes theft or fraud by the employee that materially harms X.

Some employees of X have requested (i) permission to transfer their shares of X to a trust for the benefit of themselves and/or their family members, or (ii) that the shares of X that would otherwise be issued to them pursuant to the Plan instead be issued to such a trust. X will confirm that the trusts are eligible S corporation shareholders. Shares held in such trusts will be subject to the same restrictions under the Agreement and the Plan as shares directly held by employees.

X represents that the Agreement and the Plan were not created as a plan to circumvent the one class of stock requirement for S corporations.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) 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.

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 relating to distribution and liquidation proceeds (collectively, the governing provisions).

Section 1.1361-1(l)(2)(iii)(B) provides that bona fide agreements to redeem or purchase stock at the time of death, divorce, disability, or termination of employment are disregarded in determining whether a corporation's shares of stock confer identical rights.

Conclusion

Based solely on the facts submitted and representations made, we conclude that the transfer restrictions and repurchase provisions in the Agreement and the Plan will be disregarded in determining whether X's shares of stock confer identical rights.

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. In particular, no opinion is expressed on whether X otherwise qualifies 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 the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

David R. Haglund

David R. Haglund
Branch Chief, Branch 1
(Passthroughs & Special Industries)

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