

## Internal Revenue Service

Number: **202114002**  
Release Date: 4/9/2021  
Index Number: 1202.00-00

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:ITA:B05  
PLR-111854-20

Date:  
January 13, 2021

## Legend

Taxpayer  
Company =  
Predecessor =  
State  
a  
Date 1  
Date 2  
Date 3  
Month 1  
Year 1

Dear \_\_\_\_\_ :

This ruling responds to your request dated Date 1. Specifically, you request a ruling that Predecessor and Company (collectively "Business") was engaged in a qualified trade or business as defined in § 1202(e)(3) during the time Taxpayer held stock in Company sold in Month 1.

## FACTS

Predecessor was formed as a State state law corporation in Year 1. In exchange for stock in Predecessor. Taxpayer and certain other shareholders contributed approximately \$ a of cash to Predecessor on Date 2. Predecessor converted into a State state law limited liability company on Date 3 and became Company. The conversion was treated as a tax-free reorganization within the meaning of section 368(a). Company continued to be taxed as a C corporation for federal income tax

purposes. Business has never held aggregate gross assets (as defined under sections 1202(d)(1) and (2)) exceeding \$50 million.

Business works with its customers to obtain insurance, including property, casualty, surety, worker's compensation, employee benefits, personal and medical, and professional practice insurance. As further explained below, Business conducts business either as a representative or appointed agent of insurance companies or as an agent appointed with a general wholesale agent.

Business operates under two general business models. First, it has contracts with insurance companies (referred to as "direct appointments") to sell a product. Insurance companies use this model to select and control who can sell the company's products. For example, an insurance company may only want to work with certain agents capable of a certain sales volume, thus excluding smaller agencies. Only independent agency companies with direct agency appointment contracts have access to these insurance products. Business generates revenue directly from the insurance company, often in the form of commissions and other similar compensation arrangements paid either directly from the insurance company or through withholding on a portion of a customer's premium payments. Contracts with insurance companies require Business to perform a number of administrative services. For example, Business must promptly report all known incidents, claims, suits and notices of loss to the insurance company or its designated claims adjuster and cooperate fully to facilitate any investigation, adjustment, settlement and payment of any claim. It also must keep true and complete records and accounts of all transactions and correspondence with the insureds at its principal office, which records and accounts must be open to examination, inspection, verification and audit by the insurance company upon reasonable notice. In some cases, Business contracts with "program managers" or "managing general agents" who represent insurance companies, rather than contracting directly with insurance companies.

Second, Business also contracts with insurance wholesalers. Under this model, Business has a contract with a wholesaler and not an insurance company, and these wholesalers contract with multiple insurance companies. Business selects an appropriate policy for a customer provided by a wholesaler. If the customer accepts the policy, the wholesaler procures the policy from the insurance company.

Taxpayer represents that for the duration of the time Taxpayer held stock in Business sold in Month 1, at least 80 percent (by value) of the assets of Business were used in the conduct of business pursuant to the first model,

## LAW

Section 1202(a)(1) provides that in the case of a taxpayer other than a corporation, gross income does not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.

Section 1202(a)(3) provides that in the case of qualified small business stock acquired after February 17, 2009, and on or before September 26, 2010, the exclusion is 75 percent.

Section 1202(c)(2) provides that stock in a corporation is not treated as qualified small business stock unless during substantially all of the taxpayer's holding period for such stock, the corporation meets the active business requirements of subsection (e) and the corporation is a C corporation.

Section 1202(e) provides that the active business requirements are met by a corporation for any period if during such period at least 80 percent (by value) of the assets of such corporation are used by such corporation in the active conduct of one or more qualified trades or businesses, and such corporation is an eligible corporation.

Section 1202(e)(3)(A) provides that a qualified trade or business means any trade or business other than a trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

Section 1202(e)(3)(B) further excludes from the definition of a qualified trade or business any banking, insurance, financing, leasing, investing, or similar business.

## ANALYSIS

Business has been referred to as an insurance agent or broker. Thus, a question arises as to whether Business is engaged in "brokerage services," which is not a qualified trade or business for purposes of section 1202.

The term "brokerage services" is not defined in section 1202 or explained in the legislative history. H.R. Rep. No. 111, 103d Cong., 1<sup>st</sup> Sess. 601 (1993). Words in a statute generally are presumed to bear their ordinary, contemporary, common meaning. Walters v. Metro. Educ. Enters., Inc., 519 U.S. 202, 207 (1997). To ascertain the plain meaning of terms, courts have consulted the definitions of those terms in popular dictionaries. Metro One Telecommunications, Inc. v. Commissioner, 704 F.3d 1057, 1061 (9th Cir. 2012) The dictionary definition of "broker" defines the term as "one who acts as an intermediary: such as a : an agent who arranges marriages b : an agent who negotiates contracts of purchase and sale (as of real estate, commodities, or securities)." Additional, less common, meanings are "power broker" and "one who sells or distributes something." Broker, Merriam-Webster.com, <https://www.merriam-webster.com/dictionary/broker> (last visited Jan. 7, 2021). With respect to business performed pursuant to the first model described above, Business's role is not that of a mere intermediary. Contracts with insurance companies require Business to perform a

number of administrative services beyond those that would be performed by a mere intermediary facilitating a transaction between two parties. For example, Business must promptly report all known incidents, claims, suits and notices of loss to the insurance company or its designated claims adjuster and cooperate fully to facilitate any investigation, adjustment, settlement and payment of any claim. It also must keep true and complete records and accounts of all transactions and correspondence with the insureds at its principal office, which records and accounts must be open to examination, inspection, verification and audit by the insurance company upon reasonable notice.

## CONCLUSION

Based on Taxpayer's representations, we conclude that Business was engaged in a qualified trade or business as defined in § 1202(e)(3) during the time Taxpayer held stock in Business sold in Month 1.

## CAVEATS

Except as expressly provided in the immediately preceding paragraph, we do not express or imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter under any provision of law, including § 1202.

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

The rulings contained in this letter are 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 request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

John M. Aramburu  
Senior Counsel, Branch 5  
(Income Tax & Accounting)

cc: