

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Telephone Number:

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Date:
February 14, 2023

TY:

Legend:

Taxpayers =

Taxpayer Husband =

Company =

Date 1 =

Year 1 =

Year 2 =

A =

B =

C =

D =

E =

Dear :

This is in response to a letter sent on your behalf by your representatives dated . In the letter, your representatives requested on your behalf a ruling that Company was not engaged in a trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more employees within the meaning of section 1202(e)(3)(A) of the Internal Revenue Code (Code) for purposes of qualifying for the exclusion of gain under section 1202(a)(1).

FACTS

Taxpayer Husband founded the Company on Date 1 as a C corporation. On the date of its formation, the Company issued A shares constituting B% of the Company's stock to Taxpayer Husband in exchange for a \$B capital contribution. Taxpayer Husband

continuously held these shares until Year 1, when he sold C% of his interest in the Company. During Year 2, Taxpayer Husband sold the remaining D% of his interest in the Company for \$E. Taxpayers have not yet filed their Form 1040, U.S. Individual Income Tax return for Year 2.

Company is an enterprise cloud application services software company, which provides solutions tailored to the operating functions and industry-specific challenges of their clients. The Company's employees possess technical skills and knowledge which allow for effective implementation and the quality of the Company's services. However, they are trained on one or more of the Company's proprietary service delivery processes and methodology packages that are unique to the Company and may not be utilized by the employees at any other employers that may provide the same or similar service. The Company can recruit and train new employees with the required technical skillset to perform substantially identical services using its methodology packages.

LAW AND ANALYSIS

Section 1202(a) of the Code provides that 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(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 section 1202(e) and the corporation is a C corporation.

Section 1202(e)(1) provides that a corporation meets the active business requirement for purposes of section 1202(c)(2) if at least 80 percent of the assets of the corporation are used by the corporation in the active conduct of one or more qualified trades or businesses.

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, athletics, financial services, brokerage services, consulting, or any other trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

The Company's employees possess technical skills and knowledge due to training received on one or more of the Company's proprietary service delivery processes and methodology packages. Such processes and packages are unique to Company and may not be utilized by the employees at other similar companies. The Company can recruit and train new employees with the required technical skillset to perform substantially identical services using its methodology packages. Therefore, the principal asset of the Company is not the reputation or skills of one or more employees,

but the intellectual property held by the Company itself in its proprietary service delivery processes and methodology packages.

CONCLUSION

We conclude that for the purposes of section 1202(e)(3), Company is not in the trade or business where the principal asset of the trade or business is the reputation or skill of one or more of its employees.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal income tax consequences of any aspect of any transaction or item discussed or referenced in this ruling including whether the other statutory and regulatory prerequisites for exclusion of capital gain under section 1202 were satisfied. Specifically, no opinion is expressed or implied concerning whether Company meets the requirement under section 1202(e)(1)(A) that at least 80 percent (by value) of the assets of such corporation are used by such corporation in the active conduct of 1 or more qualified trades or businesses or whether the Company is engaged in a trade or business involving the performance of services in the field of consulting as defined in section 1202(e)(3)(A).

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 representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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.

Sincerely,

Erika C. Reigle
Senior Technician Reviewer, Branch 5
(Income Tax and Accounting)

cc: