

**Internal Revenue Service**

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Department of the Treasury  
Washington, DC 20224

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Date:  
February 13, 2023

Legend

Company =

State A =

Business A =

Executive =

Family  
Member =

Family  
Beneficiaries =

Person 1 =

Person 2 =

Person 3 =

Person 4 =

LLC =

Company  
Purpose =

The Exchange =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

GRAT 1 =

GRAT 2 =

GRAT 3 =

GRAT 4 =

Stock A =

Stock B =

Stock C =

Year 1 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

a =

b =

c =

d =

e =

Dear :

This letter responds to your authorized representative's letter dated August 10, 2022, requesting rulings under sections 118, 305, 2501, 2511, 2512, and 2702 of the Internal Revenue Code (the "Code"). The information provided in that letter and in later correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings, but such material is subject to verification on examination.

### **Summary of Facts**

Company is a State A corporation and the parent of an affiliated group of corporations that files a consolidated U.S. federal income tax return on a calendar year basis. Company was incorporated in Year 1. Company is engaged in Business A. Executive is an executive of Company.

On Date 1, Executive established Trust 1 for the benefit of Family Member. Also on Date 1, Executive established Trust 2 for the benefit of the Family Beneficiaries. On Date 2 and Date 4, Executive established Trust 3 and Trust 4, respectively, for the benefit of Family Member. On Date 3, Executive established Trust 5 for the benefit of Person 1. Also on Date 2, Executive established GRAT (Grantor Retained Annuity Trust) 1 for the benefit of Executive and Person 1. On Date 8, Executive established GRAT 2 and GRAT 3 for the benefit of Executive, Person 2, Person 3, Person 4, and a trust, not part of this ruling request, for Person 2, Person 3, and Person 4. On Date 9, Executive established GRAT 4 for the benefit of Trust 2. Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, GRAT 1, GRAT 2, GRAT 3, and GRAT 4 are hereinafter referred to collectively as "Trusts". Executive's interest in GRAT 4 is a "qualified interest" under section 2702(b). Executive's interests in GRAT 1, GRAT 2, and GRAT 3 are not subject to the special valuation rules of section 2702(a) because the beneficiaries of GRAT 1, GRAT 2, and GRAT 3 are not members of Executive's family as defined in section 2702(e) and section 2704(c)(2).

On Date 5, Company formed LLC, which is disregarded as an entity separate from Company for U.S. federal income tax purposes. LLC was formed for Company Purpose. However, Company is not required under the operating agreement to use LLC for Company Purpose and may dissolve LLC at any time.

Company has three classes of common stock outstanding: Stock A, Stock B, and Stock C. Stock A is widely held and, since Date 7, has been publicly traded on the Exchange. The shares of Stock A and Stock B are identical other than the voting power. Each share of Stock B has a times the voting power of each share of Stock A.

Stock B is held, in part, by Executive and GRATs 1 through 4, and Trusts 1 through 4. Trust 5 owns shares of Stock A.

All of the issued shares of Stock C are held by LLC and are not considered outstanding for U.S. federal income tax purposes. Stock C has no voting rights except as otherwise required by law. Upon the transfer to a holder other than LLC or another subsidiary of Company, shares of Stock C will automatically convert on a share-for-share basis into shares of Stock A.

On Date 6, Company made an initial contribution of b newly-issued shares of Stock C to LLC.

On Date 10, Company announced that its board of directors approved a share repurchase program with authorization to purchase Company's Stock A at the discretion of Company's management (the "**Share Repurchase Program**"). None of the Contributing Shareholders (defined below) have participated in the Share Repurchase Program. The Share Repurchase Program and the Proposed Transaction are each driven by separate valid business purposes.

Executive, Trusts, and Company intend to enter into a binding agreement ("Agreement") wherein Executive and Trusts will each surrender c percent (valued at approximately \$d) of their shares of Stock A or Stock B, as the case may be, to Company. Company will subsequently retire those contributed shares and will transfer a like number of newly issued shares of Stock C to LLC.

### **Proposed Transaction**

For what are represented to be valid business purposes, the following transaction has been proposed (the "Proposed Transaction"):

- (i) Trusts and Executive (each a "**Contributing Shareholder**", and collectively, the "**Contributing Shareholders**") will contribute in one or more installments a portion of their Stock A or Stock B to the capital of Company for the benefit of LLC. Executive intends to contribute stock of an amount equal to approximately \$d or c percent of shares of Stock B owned by Executive. The Trusts will contribute a number of shares to Company that is proportionate on a percentage basis to the number of shares contributed by Executive (collectively, the "**Contribution**") or approximately c percent of their shares of Stock A or Stock B, as the case may be, to the capital of Company.

The Contributing Shareholders and Company will enter into a binding agreement pursuant to which the Contribution will be effected (the “**Contribution Agreement**” or “**Agreement**”). The Contribution may take place in more than one installment. The Contributing Shareholders and Company will enter into a new Contribution Agreement for each separate contribution, if any. The shareholders of Company other than the Contributing Shareholders are referred to as the “**Non-Contributing Shareholders**”.

- (ii) When Company receives shares from Contributing Shareholders pursuant to the Contribution Agreement, Company will retire such shares and transfer a like number of newly issued shares of Stock C to LLC.
- (iii) LLC will use cash derived from Stock C for Company Purpose.
- (iv) Company owns all of the membership interests of the LLC and therefore will control the policies of LLC related to the Company Purpose.

### **Representations**

Company and the Contributing Shareholders make the following representations regarding the Proposed Transaction:

- (a) The Contributing Shareholders will not receive any consideration from Company with respect to the surrender of their stock to the capital of Company in the Proposed Transaction.
- (b) The stock surrendered to the capital of Company in the Proposed Transaction will be canceled and such stock or similar shares of stock of Company will not be returned to the Contributing Shareholders following the Proposed Transaction.
- (c) Company does not intend to fund LLC with property other than Stock C or cash.
- (d) GRAT 1, GRAT 2, GRAT 3, and GRAT 4 each have the terms necessary to satisfy the requirements to be a qualified interest under § 25.2702-3 of the Gift Tax Regulations.
- (e) There is no plan to transfer the shares of Stock C to any employee or independent contractor in connection with the performance of services within the meaning of section 83 or otherwise.
- (f) The Contributing Shareholders are not related to any of the Non-Contributing Shareholders such that stock ownership of a Contributing Shareholder would be attributed to a Non-Contributing Shareholder pursuant to section 318(a)(1) or section 267(c)(2).

- (g) There is no reason to believe that any of the stock purchases pursuant to the Share Repurchase Program will be taxed as dividends to the participating shareholders and there is no reason to believe that such stock purchases are dividends within the meaning of sections 301 and 302.
- (h) The Proposed Transaction is an isolated transaction that is not related to any other past or future transactions.
- (i) The Proposed Transaction is motivated solely by the Contributing Shareholders' and Company's business considerations and is not motivated by any intent to confer a U.S. federal income tax benefit on any shareholder, including as a substitute for a dividend.
- (j) The Proposed Transaction is not part of a plan to periodically increase the proportionate share of any shareholder in the assets or earnings and profits of Company.
- (k) There is no plan for the Contributing Shareholders to make contributions to Company that are not otherwise described herein.
- (l) If the Contributions pursuant to the Proposed Transaction occur in more than one installment, the final contribution will occur within a e month period of the first contribution.
- (m) Persons 1 through 4 are not employees of Company or Executive.

### **Transactional Rulings**

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

- (1) The surrenders of Stock A or Stock B by the Contributing Shareholders to Company in the Proposed Transaction are a non-taxable contribution to the capital of Company and accordingly, the Contributing Shareholders will not recognize gain or loss on such contribution. See *Commissioner v. Fink*, 483 U.S. 89 (1987).
- (2) Each Contributing Shareholder's basis in the shares surrendered in the Proposed Transaction will be allocated to the Contributing Shareholder's basis in their remaining shares. See *Commissioner v. Fink*, 483 U.S. 89 (1987).
- (3) Company's receipt of shares of Stock A or B from the Contributing Shareholders will not be taxable to Company. See section 118(a).
- (4) The Non-Contributing Shareholders will not recognize any income as a result of the Proposed Transaction and the Contributing Shareholders' surrender of

shares to Company will not be treated as a distribution of property to the Non-Contributing Shareholders. See Treas. Reg. §§ 1.305-3(b)(3) and 1.305-3(e), Example (13). See also Rev. Rul. 77-19, 1979-1 C.B. 83.

### **Gift Tax Rulings**

#### Ruling 5

Under section 2501(a)(1) of the Code, tax is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident, or nonresident.

Under section 2511(a), the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Under section 2512(b), where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

Section 25.2511-1(c)(1) of the Gift Tax Regulations provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Under § 25.2511-1(g)(1), the gift tax is not applicable to a transfer for a full and adequate consideration in money or money's worth, or to ordinary business transactions, described in § 25.2512-8.

Under § 25.2511-1(h), a transfer of property by B to a corporation generally represents gifts by B to the other individual shareholders of the corporation to the extent of their proportionate interests in the corporation.

Under § 25.2512-8, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth.

In Rev. Rul. 80-196, 1980-2 C.B. 32, two shareholders transferred stock to three employees as a bonus in consideration of past services to the corporation. The two shareholders were not related to the three employees, nor did any special personal relationship exist between the shareholders and the three employees. The ruling holds, for gift tax purposes, that the transfers to the three employees were in the ordinary course of business under § 25.2512-8 because the transfers were motivated by a valid



business reason, that is, retaining valuable personnel in the employment of the corporation. Therefore, the transfers were not subject to gift tax.

In *Anderson v. Commissioner*, 8 T.C. 706 (1947), senior executives of a corporation sold shares to junior executives as part of a plan to shift management responsibilities to the junior executives. The Tax Court held that the sale was not subject to gift tax because it was made in the ordinary course of business. See *Galluzzo v. Commission*, 43 T.C.M. 199 (T.C. 1981).

Company is owned by Executive, Trusts, and Non-Contributing Shareholders. In Agreement, Executive and Trusts agree to surrender shares to Company in order to fund LLC. By entering into Agreement, Executive and Trusts are increasing the value of the shares held by the Non-Contributing Shareholders. For gift tax purposes, this transfer is characterized as an indirect transfer of property from Executive and Trusts to Non-Contributing Shareholders. See §§ 25.2511-1(c)(1) and 25.2511-1(h). See also Rev. Rul. 71-443, 1971 C.B. 337; *Bosca v. Commissioner*, T.C. Memo. 1998-251; *Kincaid v. United States*, 682 F.2d 1220 (5<sup>th</sup> Cir. 1982); *Estate of Trenchard*, T.C. Memo. 1995-121.

Under § 25.2512-8, a transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for adequate and full consideration in money or money's worth. Under the facts presented in this ruling, the transfer made through Agreement satisfies all three of the requirements to be considered as made in the ordinary course of business. First, Agreement is for the bona fide business purpose of furthering Company Purpose. Second, the transfer from Executive and Trusts to Non-Contributing Shareholders is at arm's length because the transaction is a business transaction, the parties act in their own self-interest and are not subject to pressure from the other parties, and the Non-Contributing Shareholders are not related to Executive or Trusts. Finally, the transfer is made without donative intent because the transfer is made for the sole purpose of furthering Company Purpose. Accordingly, the indirect transfer from Executive and Trusts to the Non-Contributing Shareholders is deemed to be made for adequate and full consideration in money or money's worth. Therefore, based on the facts presented and the representations made, the transfers made to the Non-Contributing Shareholders pursuant to Agreement do not constitute gifts from Executive or Trusts.

By entering into Agreement, each party is increasing the value of the shares held by others (i.e., Executive is increasing the value of the shares held by Trusts, Trusts are increasing the value of shares held by Executive, and each individual trust is increasing the value of each other individual trust). The transfers between Executive and Trusts are not at arm's length, and, therefore, they are not made in the ordinary course of business. However, under Agreement, Executive and Trusts are each surrendering an equal proportion of their shares of Company, and, consequently, the value of the indirect transfers made by each of the parties to the Agreement will be equal to the

value of the indirect transfers received by each party. Accordingly, the indirect transfers made from Executive to Trusts and from Trusts to Executive (and each other trust) are made for full and adequate consideration in money or money's worth. Therefore, based on the facts presented and the representations made, the Contributing Shareholders will not be subject to gift tax under sections 2501, 2511, 2512, and regulations thereunder as a result of the Proposed Transaction.

### Ruling 6

Section 2702(a)(1) provides that solely for purposes of determining whether a transfer of an interest in trust to (or for the benefit of) a member of the transferor's family is a gift (and the value of such transfer), the value of any interest in such trust retained by the transferor or any applicable family member (as defined in section 2701(e)(2)) shall be determined as provided in section 2702(a)(2).

Section 2702(a)(2)(A) provides that the value of any retained interest which is not a qualified interest shall be treated as being zero.

Section 2702(b) provides that the term "qualified interest" means: (1) any interest which consists of the right to receive fixed amounts payable not less frequently than annually, (2) any interest which consists of the right to receive amounts which are payable not less frequently than annually and are a fixed percentage of the fair market value of the property in the trust (determined annually), and (3) any noncontingent remainder interest if all of the other interests in the trust consist of interests described in paragraph (1) or (2).

Section 25.2702-2(a)(6) provides, in part, that a qualified interest means a qualified annuity interest, a qualified unitrust interest, or a qualified remainder interest.

Section 25.2702-3(b)(1) provides that an interest is a qualified annuity interest only if it meets the requirements of this paragraph and § 25.2702-3(d). A qualified annuity interest is an irrevocable right to receive a fixed amount. The annuity amount must be payable to (or for the benefit of) the holder of the annuity interest at least annually.

Under § 25.2702-3(d)(3), the governing instrument must prohibit distributions from the trust to or for the benefit of any person other than the holder of the qualified annuity or unitrust interest during the term of the qualified interest.

The terms of GRAT 4 prohibit distributions to anyone other than Executive during the term of Executive's interest in GRAT 4 in accordance with § 25.2702-3(d)(3). Under the terms of Agreement, the contribution of shares to Company and resulting indirect transfer from GRAT 4 to Executive and Non-Contributing Shareholders will be made for adequate and full consideration in money or money's worth within the meaning of § 25.2511-1(g)(1). Accordingly, such transfers are not characterized as distributions from GRAT 4. These transfers are deemed investments because GRAT 4 receives or

is deemed to receive value in money or money's worth equal to the transfer. As a result, GRAT 4 will not violate the terms of the trust instruments or the requirement under § 25.2702-3(d)(3) prohibiting a distribution for the benefit of any person other than Executive during the term of Executive's qualified interest. Therefore, based on the facts presented and the representations made, Executive's interest in GRAT 4 will not cease to qualify as a qualified interest under § 25.2702-3 or otherwise under section 2702(b) as a result of the Proposed Transaction.

### **Caveats**

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.

### **Procedural Statements**

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.

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.

Sincerely,

Gerald B. Fleming  
Senior Technician Reviewer, Branch 2 (Corporate)

cc: