

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
May 17, 1999

Legend

Corporation =

State A =

Date X =

Year 1 =

Year 2 =

Year 3 =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

a =

b =

c =

d =

Dear _____ :

This letter responds to your letter dated January 7, 1999, requesting a ruling concerning the federal income tax consequences of a proposed transaction. The information submitted for consideration is set forth below.

Corporation is a sub-chapter C corporation organized under the laws of State A on Date X. Corporation has 100 shares of common stock issued and outstanding.

From Year 1 until Year 2, Shareholder 2 was the sole owner of Corporation. In Year 2, Shareholder 2 began a stock transfer gift program to his son, Shareholder 3, an active employee of Corporation, with the intent that Shareholder 3 would eventually become the sole owner of the company. The stock transfer gift program continued until Year 3, when Shareholder 2 unexpectedly died, at which point Shareholder 2 owned a shares and Shareholder 3 owned b shares of Corporation.

Upon Shareholder 2's death, his a shares of Corporation passed to Shareholder 1 who is Shareholder 2's wife and Shareholder 3's mother. Shareholder 1 is currently a director and the vice president of Corporation. Shareholder 1 resumed Shareholder 2's stock transfer gift program by transferring an additional c shares of Corporation to Shareholder 3.

Shareholder 1 now desires to completely terminate her interest as shareholder, director, officer, and employee of Corporation and retire from all participation in its affairs in any capacity. Accordingly, Corporation proposes to redeem all of the stock held by Shareholder 1 in Corporation, leaving Shareholder 3 as the sole owner of Corporation (the "redemption"). The redemption price will be the fair market value of the stock at the end of the nearest quarter preceding the redemption. Corporation will pay half of the redemption price in cash and the other half by delivering an unsecured installment promissory note (the "Note") with interest at d% per annum. The redemption will result in a loss to which section 267 of the Code will apply. In connection with the redemption, Shareholder 1 will resign as director, officer, or employee in any other capacity in Corporation. However, shareholder 1 will continue to be covered as a retiree under Corporation's unfunded medical reimbursement plan.

Shareholder 1 received the stock to be redeemed within the ten year period

preceding the redemption. Except for gifts from Shareholder 1 of c shares, Shareholder 3 will not after the redemption own stock of Corporation acquired from Shareholder 1 within the ten year period preceding the redemption.

Although Shareholder 3 was the holder of an option (Option Agreement) to purchase the shares of Shareholder 2 in the event of his death, Corporation will redeem Shareholder 2's shares bequeathed and currently owned by Shareholder 1. Under the Option Agreement, Shareholder 3 did not have a primary and unconditional obligation to purchase the stock from Shareholder 2.

In connection with the proposed redemption, the following representations have been made:

- 1) There are no outstanding options or warrants to purchase Corporation stock, nor are there any outstanding debentures or other obligations that are convertible into corporation stock or would be considered Corporation stock.
- 2) In no event will the last payment on any note or other obligation be made more than 15 years after the date of issuance of the note or other obligation.
- 3) The amount to be paid on the Note, including interest, is a fixed amount payable at a fixed time and the amount or time of payment is not subject to any change or adjustment.
- 4) None of the consideration from Corporation, including interest, consists entirely or partly of Corporation's promise to pay an amount that is based on, or contingent on, future earnings of Corporation, an amount that is contingent on working capital being maintained at a certain level, or any other similar contingency.
- 5) Any note or other obligation to be issued to a redeemed shareholder will not be subordinated to the claims of general creditors of Corporation.
- 6) In the event of default on any note or other obligation, no shares of stock will revert to or be received by a redeemed shareholder nor will any redeemed shareholder be permitted to purchase the stock at public or private sale.
- 7) No shareholder of Corporation has been or will be obligated to purchase any of the stock in Corporation that is to be redeemed.
- 8) The redemption described in this ruling request is an isolated transaction and is unrelated to any other past or future transaction.
- 9) There have been no redemptions, issuances, or exchanges by the

Corporation of its stock in the past five years.

10) Corporation has no plan or intention to issue, redeem, or exchange additional shares of its stock.

11) There have not been nor will be any distributions, redemptions, or issuances of stock of any related corporation.

12) Neither the disposition of Corporation stock by the estate nor the gifts by the redeemed shareholder had as one of their principal purposes the avoidance of federal income tax.

13) After the redemption, no redeemed shareholder will have any interest in Corporation, including an interest as officer, director, or employee, (other than an interest as a creditor as described in section 1.302-4(d) of the Income Tax Regulations, and constructive ownership under section 318(a)(1) of the Code).

14) Each redeemed shareholder will execute and file the agreement required by section 302(c)(2)(A)(iii) of the Code with respect to the acquisition of any interest in Corporation within 10 years from the date of the redemption.

15) None of the stock to be redeemed is "section 306" stock within the meaning of section 306(c) of the code. The stock to be redeemed is common stock and was not received in exchange for preferred stock.

16) There are no declared but unpaid dividends, or funds set apart for dividends, on any of the stock to be redeemed.

17) At the time of the exchange, the fair market value of the consideration to be received by the redeemed shareholder will be approximately equal to the fair market value of the Corporation stock to be exchanged therefor.

Based solely on the facts submitted and the representations made above, we hold as follows:

1) The redemption will be treated as a distribution in full payment in exchange for the stock redeemed as provided in section 302(b)(3).

2) Pursuant to section 302(c)(2), section 318(a)(1) will not apply to the redemption.

3) Shareholder 3, the remaining shareholder of Corporation, will not receive a constructive dividend as result of the redemption by Corporation of its stock held by Shareholder 1.

No opinion is expressed about the tax treatment of the redemption under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the redemption that are not directly covered by the above rulings.

This ruling letter 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.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Sincerely,

Assistant Chief Counsel (Corporate)

By: _____
Mark S. Jennings
Senior Technician Reviewer, Branch 1