

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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LEGEND:

Company =

State A =

Business B =

Year 1 =

Year 2 =

Redeeming
Shareholder =

Z Shareholders =

Family L =

Family M =

Family N =

Trust W =

Plan P =

X =

Y =

K =
\$F =
\$G =
Q =
R =
S =
T =
U =
V =

Dear :

We respond to your letter dated May 8, 2002, in which you requested rulings under § 302(b)(1) of the Internal Revenue Code concerning the federal income tax consequences of a proposed transaction. The information submitted in that letter and in letters dated July 9, 2002 and July 19, 2002 is summarized below.

Company is an S-corporation incorporated in State A, and is engaged in Business B. Company is an accrual method taxpayer with a December 31 year end. Company has outstanding a single class of common stock comprised of both voting common stock and non-voting common stock. All of the outstanding common shares of Company are held by members of Family L and trusts whose beneficiaries are members of Family L.

Family L is divided along two descendent lines, the Family M line and Family N line. Company is owned Q percent by Family M and R percent by Family N. Family M cannot assert control of Company.

In Year 1, Company adopted Plan P whereby Company would annually, at the discretion of Company's board of directors, offer to purchase outstanding shares of Company from its shareholders. The purpose of Plan P was to provide shareholders of Company with an opportunity to dispose of their outstanding shares, as Company is a closely held corporation and therefore there is no public market on which to dispose of Company stock.

Under the rules of Plan P, the board of directors determines on a yearly basis whether it is in the best interest of Company and the shareholders to redeem any shares. If Company decides to redeem, the shareholders are notified in writing of the opportunity, and in response, Company obtains an independent appraisal of the fair market value of Company stock. The redemption price for any shareholder who tenders her stock for redemption is set at the appraised value per share. After the appraisal is complete, neither Company nor the shareholders who expressed interest in redeeming shares is obligated to actually complete the redemption. Furthermore, although a shareholder may tender any shares for redemption, Company may elect to reject the tender and not redeem any stock in that year. Additionally, Company may, on a yearly basis, set limits related to the aggregate number of shares that will be redeemed, or the aggregate amount of money that will be spent on the redemption in a given year.

Redeeming Shareholder is a member of the Family M descendent line of Family L. Redeeming Shareholder is not active in the management of Company and he is not an employee, director, or officer of Company. Additionally, neither Redeeming Shareholder's wife, children, nor any of the trusts in which he possesses a beneficial interest are involved in the management of Company.

Redeeming Shareholder is a minority shareholder who directly owns X shares of voting stock of Company, which represent S percent of the total shares of common stock outstanding in Company. As part of Plan P, Redeeming Shareholder has notified Company that he would like to redeem X shares of Company stock in Year 2 at an appraised value of \$F per share for a total of \$G. Since the adoption of Plan P, Redeeming Shareholder has not redeemed any of his shares of stock.

Through the attribution rules under § 318, Redeeming Shareholder is deemed to own shares held by his wife, children, and several trusts of which he is a beneficiary. The total shares attributed to Redeeming Shareholder is Y shares. Therefore, Redeeming Shareholder owns directly and through attribution T percent of Company. Redeeming Shareholder has no power of appointment over any of the trusts through which shares are attributed to him. Redeeming Shareholder is a trustee of Trust W, one of the trusts through which shares are attributed to him. The other trustees of Trust W, however, are unrelated to Redeeming Shareholder, and Trust W's rules require a majority of the trustees to agree in order for the trust to act.

Z Shareholders, certain Company shareholders other than Redeeming Shareholder, have notified Company that they wish to redeem or may wish to redeem, in the aggregate, K shares of Company stock in Year 2. Redeeming Shareholder is not attributed any of the shares of stock held by Z Shareholders, and the impact of their redemptions on the redemption by Redeeming Shareholder is minimal.

After the proposed redemption, Redeeming Shareholder will own U percent of Company outright and V percent of Company through attribution assuming Z Shareholders redeem, in the aggregate, K shares of Company stock in Year 2.

The following representations have been made in connection with the proposed transaction:

- A. There are no outstanding options or warrants to purchase Company's stock, nor are there any outstanding debentures or other obligations that are convertible into Company stock or would be considered Company stock.
- B. No notes or other obligations of Company will be distributed to a redeemed shareholder.
- C. No shareholder of Company has been or will be obligated to purchase any of the stock to be redeemed.
- D. None of the stock to be redeemed is "section 306 stock" within the meaning of § 306(c) of the Code.
- E. There are no declared but unpaid dividends or funds set apart for dividends, on any of the stock to be redeemed.
- F. At the time of the exchange, the fair market value of the consideration to be received by Redeeming Shareholder will be approximately equal to the fair market value of Company stock to be exchanged therefore.
- G. The price to be paid for Company stock to be redeemed will not result in a loss with respect to those shares of stock.
- H. To the best knowledge of Company's management and directors, there is no current plan or intention to redeem Company stock other than the redemptions of Company stock held by Redeeming Shareholder and Z Shareholders described above.

Based solely upon the information submitted and the representations set forth above, we hold as follows:

1. Provided that no Company shares are redeemed in Year 2 other than K shares by Z Shareholders noted above, the redemption by Redeeming Shareholder of X shares of Company stock is not essentially equivalent to a dividend under § 302(b)(1). The distribution in redemption of the stock owned by Redeeming Shareholder shall be treated as a distribution in full payment in exchange for

stock owned by Redeeming Shareholder as provided in § 302(a). See U.S. v. Davis, 397 U.S. 301 (1970); Rev. Rul. 75-512, 1975-2 C.B. 112; Rev. Rul. 75-502, 1975-2 C.B. 111; Rev. Rul. 56-183, 1956-1 C.B. 161.

2. Redeeming Shareholder will realize and recognize gain under § 1001, measured by the difference between the redemption price and the adjusted basis of the shares of Company surrendered.

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.

We express no opinion concerning the federal income tax treatment of the transactions under other provisions of the Code or Regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings.

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.

A copy of this letter must be attached to any income tax return to which it is relevant. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer and another taxpayer's representative.

Sincerely yours,

Mark S. Jennings
Chief, Branch 1
Office of Associate Chief Counsel (Corporate)