

Internal Revenue Service

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Department of the Treasury

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CC:PSI:7:PLR-103651-00

Date: October 20, 2000

LEGEND:

C:

Bylaws:

Buy-Sell Agreement:

Year:

Date 1:

Date 2:

Date 3:

Date 4:

Date 5:

a:

b:

c:

d:

Dear

In a letter dated February 10, 2000, and other submissions, you requested a ruling, presented on behalf of C, on the application of § 2703 of the Internal Revenue Code to a proposed amendment to the Articles of Incorporation and Bylaws of C. This letter responds to that request.

The facts and representations submitted are as follows:

C was incorporated as a C corporation but adopted subchapter S status on Date 1. On Date 2, C amended the Articles of Incorporation to change the authorized capitalization of C to a shares of voting common stock with a par value of one dollar per share. All but b percent of the

shares are issued and outstanding. The remaining shares in C are Treasury shares. Article I, section 7(b) of the Bylaws states, in relevant part, that Treasury shares held by C in a fiduciary capacity will not be counted in determining the total number of outstanding shares at any given time.

The Bylaws of C were adopted in Year. Article V of the Bylaws contains restrictions on the voluntary transfer of stock; Article V of the Bylaws has not been amended since Year. In addition, the shareholders of C entered into the Buy-Sell Agreement on Date 3 and amended that agreement on Date 4 and Date 5. Articles II through V of the Buy-Sell Agreement contain additional restrictions on the voluntary transfer of stock

C proposes to effect a recapitalization of C with a shares of voting common stock with a par value of one dollar per share and the addition of c shares of nonvoting common stock with a par value of one dollar. Thereafter, C will declare a dividend of the nonvoting common stock with each shareholder receiving d shares of nonvoting common stock for each share of voting common stock that the shareholder currently holds. Currently, C is owned by three related shareholders.

Taxpayer represents that the only difference between the voting common stock and nonvoting common stock is the right to vote. Taxpayer further represents that the nonvoting common stock will have the right to vote as a class for certain major corporate decisions, like a merger of C that is required under the applicable state law. Finally, Taxpayer represents that the voting common stock will have the right to vote on the same matters as the nonvoting common stock plus all other matters including, but not limited to, the election of the directors.

Taxpayer represents that no amendment will be made to Article V of the Bylaws or the Buy-Sell Agreement as a result of the recapitalization of C and the issuance of nonvoting common stock.

REQUESTED RULING:

The recapitalization of C to create nonvoting common stock in addition to the voting common stock, the amendment of the Bylaws and the Articles of Incorporation to add nonvoting common stock, and the issuance of nonvoting common stock will not result in a substantial modification of the Buy-Sell Agreement or the Bylaws under § 2703.

LAW:

Section 2703(a) provides that for purposes of subtitle B, the value of any property shall be determined without regard to: (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right); or (2) any restriction on the right to sell or use such property.

Section 11602(e)(1)(A)(ii) of the Revenue Reconciliation Act of 1990, P.L. 101-508, 104 Stat. 1388, provides that § 2703 applies to: (I) agreements, options, rights, or restrictions entered into or granted after October 8, 1990; and (II) agreements, options, rights, or restrictions that are substantially modified after October 8, 1990. See § 25.2703-2.

Section 25.2703-1(a)(3) provides, in relevant part, that a right or restriction may be contained in a partnership agreement, articles of incorporation, corporate bylaws, a shareholders' agreement, or any other agreement.

Section 25.2703-1(b) provides that § 2703 does not apply to any right or restriction satisfying the following three requirements--

- (i) The right or restriction is a bona fide business arrangement;
- (ii) The right or restriction is not a device to transfer property to the natural objects of the transferor's bounty for less than full and adequate consideration in money or money's worth; and
- (iii) At the time the right or restriction is created, the terms of the right or restriction are comparable to similar arrangements entered into by persons in an arm's length transaction.

Section 25.2703-1(c)(1) generally provides that a right or restriction that is substantially modified is treated as a right or restriction created on the date of the modification. Any discretionary modification of a right or restriction, whether or not authorized by the terms of the agreement, that results in other than a de minimis change to the quality, value, or timing of the rights of any party with respect to property that is subject to the right or restriction is a substantial modification. If the terms of the right or restriction require periodic updating, the failure to update is presumed to substantially modify the right or restriction unless it can be shown that updating would not have resulted in a substantial modification. The addition of any family member as a party to a right or restriction (including by reason of a transfer of property that subjects the transferee family member to a right or restriction with respect to the transferred property) is considered a substantial modification unless the addition is mandatory under the terms of the right or restriction or the added family member is assigned to a generation (determined under the rules of § 2651) no lower than the lowest generation occupied by individuals already party to the right or restriction.

Section 25.2703-1(c)(2) provides that a substantial modification does not include--

- (i) A modification required by the terms of a right or restriction;
- (ii) A discretionary modification of an agreement conferring a right or restriction if the modification does not change the right or restriction;

(iii) A modification of a capitalization rate used with respect to a right or restriction if the rate is modified in a manner that bears a fixed relationship to a specified market interest rate; and

(iv) A modification that results in an option price that more closely approximates fair market value.

Based on the information submitted and representations made, the Articles of Incorporation, the Bylaws, and the Buy-Sell Agreement were adopted before October 9, 1990. Consequently, those three agreements are exempt from the application of § 2703 provided the Articles of Incorporation, the Bylaws, and the Buy-Sell Agreement are not substantially modified as set forth in § 25.2703-1(c).

Based on the information submitted and representations made, we conclude that the proposed amendment of the Articles of Incorporation and the Bylaws for the recapitalization of C to create voting and nonvoting common stock, and the issuance of the nonvoting common stock will not result in other than a de minimis change to the quality, value, or timing of the rights of any party with respect to property subject to the right or restriction. The proposed amendment of the Articles of Incorporation and the Bylaws, therefore, does not constitute a substantial modification for purposes of § 25.2703-1(c).

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under the cited provisions or any other provision of the Code.

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

Sincerely,
Christine E. Ellison
Chief, Branch 7
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures:

Copy of letter

Copy for § 6110 purposes