

INTERNAL REVENUE SERVICE

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January 5, 1999

Re:

Corporation =

A =

B =

C =

D =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

State N =

State O =

Q =

Date 1 =

Year 1 =

Year 2 =

Dear :

This letter replies to your letters dated May 18, 1998, and November 9, 1998, in which rulings were requested as to the federal income tax consequences of proposed transactions. The information submitted for consideration is summarized below.

Corporation is a closely held State N corporation whose principal business is sales and marketing of Q. Stock in Corporation was held by family members A, B, C, and D and by Trusts 1-9 established by the family. As the result of a dispute between A, B, C, and D, and the trustees of the trusts, a lawsuit was filed. The lawsuit was resolved by a settlement agreement executed on Date 1 (settlement agreement). Under the settlement agreement, Corporation redeemed all the stock owned by A, B, C, and D and Trusts 1, 2, and 3. C is a related person with respect to Trust 1 and D is a related person with respect to Trusts 2 and 3 within the meaning of § 302 (c)(2)(C). After the redemptions, all of the stock of Corporation was held by Trusts 4-9. The redemption of A's Corporation stock was substantially disproportionate under § 302(b)(2) with the application of the family attribution rules under § 318. The redemption of B, C, and D's Corporation stock completely terminated their shareholder interests in Corporation under the provisions of § 302(b)(3) with the application of the waiver of the family attribution rules under § 302(c)(2)(A). B, C, and D each executed and filed the agreement required in § 302(c)(2)(A)(iii) with respect to the acquisition of any interest in Corporation within 10 years from the date of the redemption.

A proposes accepting an appointment as trustee of Trust 4. A, B, C, and D propose naming one of themselves to each of the trustee succession committees of Trusts 5-9, except that they will not name any one of themselves to the trustee succession committee of a trust for which that one is the trust's grantor. The settlement agreement provides that A, B, C, and D can designate among one of themselves or descendants of their father to serve as one member of a trustee succession committee for each of Trusts 5-9. The settlement agreement further provides that the right to appoint one member to each of the trustee succession committees is not exercisable within the ten year period specified under § 302(c) unless the exercise will meet the criteria for the complete termination of the interests of B, C, and D under § 302(b) and § 302(c). The settlement agreement further provides that in the event that A, B, C, or D cannot meet the criteria of § 302(b) and § 302(c) in

appointing one of themselves or other descendants of their father to the trustee succession committees, but would be able to comply with the criteria of § 302(b) and § 302(c) by selecting a third person, A, B, C, and D will be permitted to select a third person for such position. Under the provisions of each of Trusts 5-9, the members of each trust's trustee succession committees has the right to remove and replace the trustees of that trust. A is the grantor of Trust 6, B is the grantor of Trust 7, C is the grantor of Trust 8, and D is the grantor of Trust 9.

From 1992 to the date of the redemption, C was employed by Corporation in State O. State O has an Intangible Property Tax which imposes a tax on holding stock in a corporation among other things. Corporation agreed to pay as additional compensation C's State O Intangible Property Tax on C's Corporation stock (Intangible Property Tax) and a gross-up amount sufficient to pay C's additional income taxes resulting from C's increased taxable income by the payment by State O of C's Intangible Property Tax (Gross-up Amount). Corporation failed to pay C's Intangible Property Tax and Gross-up Amount for Year 1 and 2. The settlement agreement signed by C and Corporation contained a release of each party from any obligation to the other party. Neither C nor Corporation intended that the release of each party in connection with the lawsuit would apply to Corporation's obligation to pay C's Intangible Property Tax or Gross-up Amount. Accordingly, Corporation has agreed to pay the appropriate amounts for C's Intangible Property Tax and Gross-up Amount for Year 1 and 2.

Taxpayers A, B, C, and D request the following rulings:

(a) The appointment and acceptance of A as a successor trustee for Trust 4 or as a member of one or more of the trustee succession committees of Trusts 5-9 will not result in the proceeds received by A on the redemption of A's Corporation stock being taxed as dividend income under § 301(a)(1);

(b) The appointment and acceptance of B, C, or D as a member of one or more of the trustee succession committees of Trusts 5-9 will not result in the acquisition of an interest in Corporation by B, C, or D within the meaning of § 302(c)(2)(A) and therefore the proceeds received by B, C, or D on the redemption of B, C, or D's Corporation stock will not be taxed as dividend income under § 301(a)(1);

(c) The appointment and acceptance by C or D as a member of one or more of the trustee succession committees of Trusts 5-9 will not result in the acquisition of an interest in Corporation by C or D within the meaning of § 302(c)(2)(A) and therefore the proceeds received by Trusts 1, 2, or 3 on the redemption of Trust 1, 2, or 3's Corporation stock will not be taxed as dividend income under § 301(a)(1); and

(d) The additional compensation Corporation will pay for C's Intangible Property Tax and Gross-up Amount for Year 1 and Year 2 will not result in the acquisition of an interest in Corporation by C within the meaning of § 302(c)(2)(A) and therefore the

proceeds received by C on the redemption of C's Corporation stock will not be taxed as dividend income under § 301(a)(1).

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

(1) The appointment and acceptance of A as a successor trustee for Trust 4 or as a member of one or more of the trustee succession committees of Trusts 5-9 will not result in the proceeds received by A on the redemption of A's Corporation stock being taxed as dividend income under § 301(a)(1);

(2) The appointment and acceptance of B, C, or D as a member of one or more of the trustee succession committees of Trusts 5-9 will result in the acquisition of an interest in Corporation within the meaning of § 302(c)(2)(A) and therefore the proceeds received by B, C, or D on the redemption of B, C, or D's Corporation stock will be taxed as dividend income under § 301(a)(1);

(3) The appointment and acceptance by C or D as a member of one or more of the trustee succession committees of Trusts 5-9 will result in the acquisition of an interest in Corporation within the meaning of § 302(c)(2)(A) and therefore the proceeds received by Trusts 1, 2, or 3 on the redemption of Trust 1, 2, or 3's Corporation stock will be taxed as dividend income under § 301(a)(1); and

(4) The additional compensation Corporation will pay for C's Intangible Property Tax and Gross-up Amount for Year 1 and 2 will not result in the acquisition of an interest in Corporation by C within the meaning of § 302(c)(2)(A) and therefore the proceeds received by C on the redemption of C's Corporation stock will not be taxed as dividend income under § 301(a)(1).

We express no opinion about the tax treatment of the proposed transaction under any 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 proposed transaction not specifically covered by the above rulings. In particular, we express no opinion about whether an appointment and acceptance of a third party as a member of one or more of the trustee succession committees of Trusts 5-9 will result in the acquisition of an interest in Corporation by B, C, or D within the meaning of § 302(c)(2)(A) resulting in the proceeds received by B, C, or D on the redemption of B, C, or D's Corporation stock being taxed as dividend income under § 301(a)(1).

This ruling is directed only to the taxpayers who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this ruling have been consummated.

Sincerely,
Assistant Chief Counsel
(Corporate)

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