

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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March 27, 2012

Legend

Taxpayers=

Corporation=

Father=

Child 1=

Child 2=

State=

Date 1=

aa=

bb=

cc=

dd=

ee=

ff=

gg=

Dear :

This letter responds to your letter dated September 9, 2011, in which you requested rulings under section 302(b)(3) of the Internal Revenue Code (Code). The information submitted in that letter and subsequent correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by Taxpayers and accompanied by a penalty of perjury statement executed by the appropriate parties. While this office has not verified any of the material submitted in support of your request for rulings, it is subject to verification on examination.

Summary of Facts

Corporation was incorporated under the laws of State on Date 1. Corporation has one class of issued and outstanding aa shares of voting common stock, all of which Father owns. Father is the father of Child 1 and Child 2. Father is a director and President of Corporation; Child 1 and Child 2 are directors of Corporation.

Father wants to retire and cede the management and control of Corporation to Child 1 and Child 2. As a result, Father proposes to give to Child 1 and Child 2 bb shares each of Corporation stock (the Gifts). Immediately after the Gifts, Corporation will redeem Father's remaining cc shares of Corporation stock in exchange solely for dd in cash and a promissory note (Promissory Note) for a total redemption price of ee (the Redemption). The Gifts and the Redemption constitute the Proposed Transactions.

The Promissory Note issued to Father will provide ff monthly installments of principal and interest. The monthly installments will begin within one month after the Redemption, and will continue on the first day of each month thereafter. Taxpayers represent that the stated interest rate on the Promissory Note will be no lower than the mid-term applicable Federal rate in effect as of the day on which the note is issued, compounded monthly. Taxpayers further represent that the stated principal amount of the note is less than or equal to its imputed principal amount. The redemption price, as

determined by a third-party appraisal, is based on a per share price of gg of Corporation stock.

Following the Proposed Transactions, the only outstanding shares of Corporation stock will be owned by Child 1 and Child 2, each owning bb shares.

Representations

Taxpayers make the following representations in connection with the Proposed Transactions:

- a) 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.
- b) In no event will the last payment of the Promissory Note be made more than 15 years after the date of issuance of the Promissory Note.
- c) The Promissory Note will neither be subordinated to the claims of general creditors of Corporation, nor is there any plan or intent for the Promissory Note to be subordinated to any creditor.
- d) None of the consideration from Corporation, including interest, consists entirely or partly of Corporation's promise to pay an amount that is based or contingent on future earnings of Corporation, or an amount that is contingent on working capital being maintained at a certain level, or other similar contingency.
- e) In the event of a default on the Promissory Note, no shares will revert to or be received by Father or any entity related to him, nor will Father or any entity related to him be permitted to purchase the stock at public or private sale.
- f) No shareholder of Corporation has been or will be obligated to purchase any of Father's shares of stock to be redeemed.
- g) The Redemption is related to the Gifts. Otherwise, the Redemption is an isolated transaction not related to any other past or future transactions.
- h) There have been no redemptions, issuances, or exchanges by Corporation of its stock in the past 5 years.
- i) Except for the Redemption, Corporation has no plan or intention to issue, redeem, or exchange any shares of stock.

- j) None of the stock to be redeemed was acquired by Father within the 10-year period preceding the Redemption from a person whose stock would be attributed under section 318(a) of the Code to Father at the time of the Redemption.
- k) Without regard to the Gifts, no person whose stock would be attributed to the Father under section 318(a) of the Code will own stock of Corporation after the Redemption if the stock was acquired by that person from Father within the 10-year period preceding the Redemption.
- l) 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 § 1.302-4(d), and constructive ownership under section 318(a) of the Code).
- m) Father will execute and file the agreement required by section 302(c)(2)(A)(iii) with respect to the acquisition of any interest in Corporation within 10 years from the date of Redemption.
- n) Throughout the 10-year period following the Redemption, (i) Father will at no time hold any note or other obligation of Corporation, except for Promissory Note, and (ii) Father will not enter into any contract or agreement, or have any other business relationship, with Corporation.
- o) There are no declared but unpaid dividends, or funds set apart for dividends, on any of the stock to be redeemed.
- p) None of the stock to be redeemed is section 306 stock within the meaning of section 306(c).
- q) At the time of the Redemption, the fair market value of the consideration to be received by Father will be approximately equal to the fair market value of Corporation stock to be surrendered by Father in exchange therefor.
- r) The price to be paid for Corporation's stock to be redeemed will not result in a loss with respect to those shares of stock.
- s) Corporation stock is not a marketable security as defined by section 453(f)(2).
- t) The Redemption is (i) not a disposition of personal property on the installment plan by a person who regularly sells or otherwise disposes of personal property on the installment plan and (ii) is not a disposition of personal property of a kind to be included in the inventory of any redeemed shareholder at the close of the taxable year. The promissory note to be issued to the redeemed shareholder will

not be issued in any form designed to render it readily tradable on an established securities market.

- u) The Promissory Note is not and will not be a self-cancelling promissory note.

Rulings

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

- 1) The Gifts do not have as one of their principal purposes the avoidance of federal income tax within the meaning of section 302(c)(2)(B) of the Code. See Rev. Rul. 77-293, 1977-2 C.B. 91.
- 2) Provided that Father files the agreement described in section 302(c)(2)(A)(iii) in accordance with § 1.302-4(a), and the conditions stated in section 302(c)(2)(A)(i) and (ii) are satisfied, section 318(a)(1) will not apply, and the Redemption will be a “complete termination” of Father’s interest in Corporation within the meaning of section 302(b)(3). The amount distributed in the Redemption will be treated as a distribution in full payment in exchange for the stock surrendered as provided in section 302(a).
- 3) As provided in section 1001, Father will realize and recognize gain on the Redemption. For each share of stock surrendered, the gain will be measured by the difference between the redemption price received in the exchange and the adjusted basis of such share as determined under section 1011. Provided the Corporation stock is a capital asset in the hands of Father, the gain will constitute capital gain subject to the conditions and limitations of Subchapter P of Chapter 1 of the Code. Pursuant to section 267, no loss will be allowed.
- 4) Father will qualify to report gain on the Redemption using the installment method under section 453(b). In the event the Promissory Note is cancelled or otherwise becomes unenforceable, the Promissory Note will be treated as if it were disposed of for fair market value, which will be treated as not less than its face amount under section 453B(f)(1) and (2).
- 5) Corporation will not recognize gain or loss on the distribution of the Promissory Note in redemption of its stock under section 311(a).
- 6) Provided the Redemption is not performed in satisfaction of a primary and unconditional obligation of either Child 1 or Child 2 to acquire the Corporation stock held by Father, the Redemption will not cause any dividend income to be constructively received by Child 1 or Child 2. See Rev. Rul. 58-614, 1958-2 C.B. 920 and Rev. Rul. 69-608, 1969-2 C.B. 42.

7) The interest paid by Corporation on the Promissory Note received by Father in redemption of his stock is deductible under section 163, subject to any limitations on such deduction including those described in, but not limited to, section 163(n)(4) and section 267(a)(2).

8) There is no imputed interest under sections 1274, 483 and 7872 with respect to the Promissory Note.

Caveat

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, including the tax consequences of any transactions for gift tax purposes. In addition, no opinion is expressed regarding whether the Promissory Note is bona fide debt, or whether the stated interest is qualified stated interest within the meaning of § 1.1273-1(c).

Sincerely,

Joanne M. Fay
Assistant Branch Chief, Branch 3
Office of Associate Chief Counsel (Corporate)

cc: