

Internal Revenue Service

Number: **202014007**

Release Date: 4/3/2020

Index Number: 2703.00-00, 2501.00-00,
2601.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B04

PLR-111449-19

Date: October 16, 2019

RE: Ruling request

Legend:

Company	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
Date 10	=
<u>A</u>	=
<u>B</u>	=
<u>C</u>	=
<u>D</u>	=
<u>E</u>	=
<u>F</u>	=
<u>G</u>	=
<u>H</u>	=
<u>I</u>	=
<u>J</u>	=
<u>K</u>	=
<u>L</u>	=
<u>X</u>	=

Dear _____ :

This letter responds to your personal representative's letter of May 10, 2019, requesting rulings under § 2703 of the Internal Revenue Code (Code).

On Date 1, a date prior to October 8, 1990, certain parties who were shareholders of Company entered into a Stock Redemption and Buy-Sell Agreement (Agreement). At the time of the Agreement, Company had two authorized classes of stock: common stock and preferred stock. Under paragraph 1 of the Agreement, a shareholder of Company was permitted to transfer shares to any lineal descendant of A and B, or to a trust for the benefit of shareholder's spouse if the ultimate beneficiary of such trust was a lineal descendant of A and B.

Under paragraph 2 of the Agreement, any shareholder, or a transferee of shares from a shareholder under paragraph 1 of the Agreement, that wanted to encumber or dispose of shares in Company (other than as permitted by paragraph 1 of the Agreement) was required to give Company a right of first refusal to purchase shares pursuant to a formula clause or a price fixed by the shareholders (Certificate of Agreed Value signed by all the shareholders). Paragraph 2 further provides that the purchase price is to be paid in ten annual installments.

Paragraph 8 of the Agreement provides that all shares subject to the Agreement shall bear an endorsement (Endorsement) that declares the shares are held pursuant to the Agreement. Paragraph 10 of the Agreement provides that the Agreement is binding on all successor shareholders.

On Date 1, A and B, husband and wife, their three daughters, C, D, and E (Daughters), a trust for the benefit of C, D, and E (Daughter Trust, Daughters' Trusts), and six separate trusts for the individual benefit of A and B's six grandchildren who were living on Date 1 (Grandchild, Grandchildren, Grandchild's Trust and Grandchildren's Trusts) F, G, H, I, J, and K, were parties to the Agreement. C, D and E were the only current beneficiaries of the Daughters' Trust. Each Grandchild was the sole current beneficiary of his or her respective trust.

On Date 2, a date prior to October 8, 1990, A and B created and funded with shares of Company stock a seventh Grandchild's Trust for the benefit of L ("L's Trust"), a newly-born descendant. Pursuant to Paragraph 1 of the Agreement, the gifted shares were subject to the terms of the Agreement and to the obligations of the transferors thereunder and L's Trust was prohibited from transferring such shares except in accordance with the Agreement. Pursuant to Paragraph 8 of the Agreement, the Endorsement appeared on the certificates issued to L's Trust.

The Grandchildren's Trusts (including L's Trust) are substantially similar and provide that the trustee has discretion to pay income and corpus to the Grandchild for whom a

trust was created until such Grandchild reaches age 21. At age 21, the Grandchild has the right to withdraw all of the property from his or her trust, and if not exercised, the trust will continue until such Grandchild reaches age 25 and then terminate by distribution to the Grandchild. If a Grandchild dies prior to the termination date, such Grandchild has a testamentary general power of appointment to appoint to anyone, including the Grandchild's estate.

On Date 3, A died, survived by his spouse, B, his Daughters, C, D and E, and his grandchildren, F, G, H, I, J, K and L. Pursuant to A's will, B, C, D, and E were the beneficiaries of A's estate.

During the period beginning October 8, 1990 and through Date 3, the only transfers of shares of Company stock were transfers from original parties to the Agreement to either other original parties to the Agreement or L's Trust which owned shares of Company Stock subject to the Agreement prior to October 8, 1990.

On Date 4, the trustee of the Grandchild's Trust benefitting F distributed all shares of Company stock subject to the Agreement to E, outright and free of trust.

On Date 5, B died, survived by her Daughters, C, D and E, and her grandchildren, F, G, H, I, J, K and L. Pursuant to B's will, C, D, and E were the beneficiaries of B's estate. C, D, and E executed partial disclaimers which resulted in F, G, H, I, J, K and L acquiring beneficial interests in B's estate.

On Date 6, I died and stock in the Grandchild's Trust benefitting I was allocated among and distributed to the Grandchildren's Trusts for J, K and L.

Subsequently, the trustees of the Grandchildrens' Trusts benefitting G, H, J, K, and L also distributed all shares of Company stock subject to the Agreement to the respective beneficiary, outright and free of trust. Each of F, G, H, J, K and L has previously executed an instrument wherein each consents and acknowledges that all shares of Company stock received by each from their respective Grandchild's Trust or directly from C, D or E is subject to the terms and conditions of the Agreement and each of F, G, H, J, K and L continues to be bound by the Agreement.

On Date 7, a date after October 8, 1990, Company amended the Articles of Incorporation (Articles) to change its name to the current name.

On Date 8, Company amended and restated the Articles. Also on Date 8, the Company adopted amended and restated Bylaws that included administrative changes such as name change, indemnification, and number of members constituting the Board of Directors.

On Date 9, C created and funded six trusts (GST Trusts) with shares of Company stock for the initial benefit of each of her six living nieces and nephews (F, G, H, J, K, and L).

Under the terms of the GST Trusts, the trustee has the discretion to pay income and corpus to the nephew or niece for whom the GST Trust is created (Beneficiary) for life. The Beneficiary has a testamentary special power of appointment to appoint the assets of the GST Trust to certain lineal descendants of A and B and to or for the benefit of a spouse of any such lineal descendant and, in default, the GST Trust's assets continue in trust for the benefit of such Beneficiary's lineal descendants, per stirpes. Upon receipt of a favorable ruling, C proposes to transfer additional shares of Company stock to the six GST Trusts. C and her husband intend to file Form 709 United States Gift (and Generation-Skipping Transfer Tax) Return, and elect to treat the gifts as made one-half by each under § 2513(a) of the Code and also allocate their respective GST exemption to the transfers to the GST Trusts.

On Date 10, D created three trusts (GST Trusts) for the initial benefit of each of her three children (E, G, and H). Under the terms of the GST Trusts, the trustee has the discretion to pay income and corpus to the child for whom the GST Trust is created (Beneficiary) for life. The Beneficiary has a testamentary special power of appointment to appoint the assets of the GST Trust to certain lineal descendants of A and B and to or for the benefit of a spouse of any such lineal descendant and, in default, the assets continue in trust for the benefit of such Beneficiary's lineal descendants, per stirpes. Upon receipt of a favorable ruling, D proposes to transfer shares of Company stock to the three GST Trusts. D and her husband intend to file Form 709 United States Gift (and Generation-Skipping Transfer Tax) Return, and elect to treat the gifts as made one-half by each under § 2513(a) of the Code and also allocate their respective GST exemption to the transfers to the GST Trusts.

Also, on Date 10, E created three trusts (GST Trusts) for the initial benefit of each of her three children (J, K and L). Under the terms of the GST Trusts, the trustee has the discretion to pay income and corpus to the child for whom the GST Trust is created (Beneficiary) for life. The Beneficiary has a testamentary special power of appointment to appoint the assets of the GST Trust to certain lineal descendants of A and B and to or for the benefit of a spouse of any such lineal descendant and, in default, the assets continue in trust for the benefit of such Beneficiary's lineal descendants, per stirpes. Upon receipt of a favorable ruling, E proposes to transfer shares of Company Stock to the three GST Trusts. E and her husband intend to file Form 709 United States Gift (and Generation-Skipping Transfer Tax) Return, and elect to treat the gifts as made one-half by each under § 2513(a) of the Code and also allocate their respective GST exemption to the transfers to the GST Trusts.

As a result of the transfers of shares of Company stock since the Agreement date, Date 1, Company is now owned by Daughters, C, D, and E, six living grandchildren F, G, H, J, K, and L, as well as six GST Trusts created by C on Date 9.

The Board of Directors of Company proposes to cancel all shares of Company common stock held in treasury and to recapitalize Company so that newly issued voting stock in Company can thereafter be primarily held by shareholders who are active in the

management of Company. To accomplish this, Company will amend its Articles to increase the number of common shares and to immediately convert each outstanding common share into one share of Class A voting common stock and $\frac{1}{x}$ shares of Class B nonvoting common stock. After adoption of the foregoing amended capital structure, the Articles and the Agreement will be amended to reflect the common stock split and the addition of the Class B nonvoting common stock (Plan of Recapitalization).

In addition and as indicated above, after approval of the changes to the corporate structure, C, D and E propose to transfer shares of her Class B nonvoting common stock to the GST Trusts created by her on Date 9 (with respect to C) and Date 10 (with respect to each of D and E).

You have requested the following rulings:

1. None of the transfers of Company shares, subject to the Agreement, after October 8, 1990 constitute substantial modifications to the Agreement within the meaning of § 25.2703-1(c) and, consequently, the Agreement continues to be grandfathered for purposes of chapter 14.
2. None of the amendments to the Articles on Date 7, the amendments and restatement of the Articles on Date 8, and the amendment and restatement of the Bylaws on Date 8 constitute substantial modifications of any right or restriction in the Articles, the Bylaws, or the Agreement within the meaning of § 25.2703-1(c) and, consequently, the Articles, the Bylaws, and the Agreement continue to be grandfathered for purposes of chapter 14.
3. The proposed Plan of Recapitalization, which includes (i) the split of each share of Company common stock into one share of Class A voting common stock and $\frac{1}{x}$ shares of Class B nonvoting common stock, (ii) the proposed amendments to the Articles and Agreement to reflect the stock split and the addition of Class B nonvoting common stock to the capital structure, and (iii) the issuance of Class B nonvoting common stock, will not constitute a substantial modification of the Articles or the Agreement within the meaning of § 25.2703-1(c) and will not cause § 2703 to apply to transfers of shares of Company stock subject to the Agreement, as amended.
4. The proposed transfers of shares of Class B nonvoting common stock by C, D and E to the respective GST Trusts created by each will not constitute a substantial modification of the Agreement within the meaning of § 25.2703-1(c) and will not cause § 2703 to apply to the transfer of shares of Company stock subject to the Agreement, as amended.

LAW AND ANALYSIS

Section 2703(a) provides that, for purposes of estate, gift, and generation-skipping transfer taxes, 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.

Under § 11602(e)(1)(A)(ii) of the Revenue Reconciliation Act, P.L. 101-508, 104 Stat. 1388, § 2703 applies to agreements, options, rights, or restrictions entered into or granted after October 8, 1990, and agreements, options, rights, or restrictions in existence prior to October 8, 1990 that are substantially modified after that date. See § 25.2703-2 of the Gift Tax Regulations.

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(c)(1) 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.

Examples 2 and 3 of § 25.2703-1(d) illustrate the rules under § 25.2703-1(c)(1). In Example 2, T and T's child, C, each own 50 percent of the outstanding stock of X corporation. T and C enter into an agreement in 1987 providing for the disposition of stock held by the first to die at the time of death. The agreement also provides certain restrictions with respect to lifetime transfers. In 1992, as permitted (but not required) under the agreement, T transfers one-half of T's stock to T's spouse, S. S becomes a party to the agreement between T and C by reason of the transfer. The transfer is the addition of a family member to the right or restriction. However, it is not a substantial modification of the right or restriction because the added family member would be assigned to a generation under § 2651 no lower than the generation occupied by C.

In Example 3, the facts are the same as in Example 2. In 1993, the agreement is amended to reflect a change in the company's name and a change of address for the company's registered agent. These changes are not a substantial modification of the agreement conferring the right or restriction because the right or restriction has not changed.

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.

Section 25.2703-2 provides that § 25.2703-1 applies to any right or restriction created or substantially modified after October 8, 1990, and is effective as of January 28, 1992. With respect to transfers occurring prior to January 28, 1992, and for purposes of determining whether an event occurring prior to January 28, 1992 constitutes a substantial modification, taxpayers may rely on any reasonable interpretation of the statutory provisions. For these purposes, the provisions of the proposed regulations and final regulations are considered a reasonable interpretation of the statutory provisions.

Section 2651(a) provides that for purposes of chapter 13, the generation to which any person (other than the transferor) belongs shall be determined in accordance with the rules set forth in § 2651.

Section 2651(b)(1) provides that an individual who is a lineal descendant of a grandparent of the transferor shall be assigned to that generation which results from comparing the number of generations between the grandparent and such individual with the number of generations between the grandparent and the transferor.

Section 2651(f)(1) provides that, except as provided in the regulations, an individual who, but for this subsection, would be assigned to more than one generation shall be assigned to the youngest such generation.

Section 2651(f)(2) provides that, except as provided in paragraph (3) regarding certain charitable organizations and governmental entities, if an estate or trust has an interest in property, each individual having a beneficial interest in such entity shall be treated as having an interest in such property and shall be assigned to a generation under the foregoing provisions of § 2651.

Section 2652(c) provides that, for purposes of chapter 13, a person has an interest in property held in trust if (at the time of the determination is made) such person (A) has a right (other than a future right) to receive income or corpus from the trust, (B) is a

permissible current recipient of income or corpus from the trust and is not described in § 2055(a), or (C) is described in § 2055(a) and the trust is (i) a charitable remainder annuity trust, (ii) a charitable remainder unitrust within the meaning of § 664, or (iii) a pooled income fund within the meaning of § 642(c)(5).

Ruling #1

The individuals and trusts who were parties to the Agreement as of Date 1 are A, B, C, D, E, the Daughters' Trust, and the six Grandchildren's Trusts (excluding L's Trust). Under § 2651, A and B, as parents and grandparents of the other parties to the Agreement, are assigned to the eldest generation, which will be referred to as the First Generation. C, D and E, as children of A and B, are assigned to the generation immediately below the First Generation and will be referred to as the Second Generation. The Daughters' Trusts are also assigned to the Second Generation because C, D and E are the only current beneficiaries of the Daughters' Trusts. The six Grandchildren's Trusts (excluding L's Trust) are assigned to the Third Generation, as each trust benefits only a grandchild of A and B.

There are nine transactions or events after October 8, 1990, in which new parties were treated as having been added to the Agreement. The nine events occurred as follows: (i) on Date 3 with the addition of A's estate upon the death of A; (ii) through (vii) through the addition of F, G, H, J, K, and L, on the date each respective Grandchild's Trust distributed shares of Company stock subject to the Agreement to each such Grandchild, outright and free of trust; (viii) on Date 5 with the addition of B's estate upon the death of B, and (ix) on Date 9 when C transferred shares of her Company stock to the GST Trusts C created, each benefiting a niece or nephew of C.

On Date 2, a date after Date 1 but prior to October 8, 1990, A and B created and funded with shares of Company stock a seventh Grandchild's Trust for L (L's Trust), a newly-born descendant. Since L's Trust was not in existence on Date 1, L's Trust was not a party to the Agreement. However, L's Trust was treated as having been added to the Agreement when it received the shares of Company stock from A and B. Pursuant to Paragraph 1 of the Agreement, the gifted shares were subject to the terms of the Agreement and to the obligations of the transferors thereunder and L's Trust was prohibited from transferring such shares except in accordance with the Agreement. Pursuant to Paragraph 8 of the Agreement, the Endorsement appeared on the certificates issued to L's Trust. Accordingly, the addition is mandatory under the terms of the right or restriction within the meaning of § 25.2703-1(c)(1).

Further, under § 2651(f)(2), L's Trust is assigned to the same generation as the sole beneficiary, L, a grandchild of A and B. Therefore, L's Trust is assigned to the Third Generation of family members already parties to the Agreement. Accordingly, L's Trust is assigned to a generation no lower than the lowest generation occupied by individuals already party to the right or restriction, within the meaning of § 25.2703-1(c).

On Date 3, A died, survived by his spouse, B, and his Daughters, C, D, and E, and his grandchildren. Pursuant to A's will, B, C, D, and E were the beneficiaries of A's estate. Accordingly, pursuant to § 2651(f)(1) and (2), A's estate was assigned to the Second Generation of shareholders already parties to the Agreement. Accordingly, the addition of A's estate to the Agreement was the addition of a family member of no lower a generational assignment than the family members already party to the Agreement on Date 1.

On Date 4, and subsequently, the trustee of the Grandchildren's Trusts benefiting F, G, H, J, K, and L distributed shares of Company stock subject to the Agreement to the grandchild for whom a Grandchild's Trust was held, outright and free of trust. The foregoing transfers for J, K and L included shares of Company stock received from Grandchild's Trust for I upon I's death. F, G, H, J, K, and L were treated as having been added to the Agreement when shares of Company stock were distributed to them, outright and free of trust. Pursuant to § 2651(f)(2), each Grandchild's Trust was assigned to the same generational assignment as its sole beneficiary, a grandchild of A and B. Therefore, the addition of the beneficiary of each Grandchild's Trust to the Agreement was the addition of a family member of no lower a generational assignment than the individuals already party to the Agreement as of Date 1.

On Date 5, B died, survived by her Daughters, C, D, and E, and her grandchildren. B's estate is treated as a new party to the Agreement. Pursuant to B's will, C, D, and E were the beneficiaries of B's estate. C, D, and E executed partial disclaimers which resulted in F, G, H, I, J, K, and L acquiring beneficial interests in B's estate. Pursuant to § 2651(f)(1) and (2), B's estate is treated as being assigned to the Third Generation of shareholders. Therefore, the addition of B's estate to the Agreement was the addition of a family member of no lower than the generational assignment of the individuals already party to the Agreement as of Date 1.

On Date 9, C created and funded six GST Trusts with shares of Company stock for the initial benefit of each of her six living nieces and nephews. A niece or nephew of C, each of whom is also a grandchild of A and B, is the sole beneficiary of each GST Trust for and during the lifetime of each such beneficiary. There are no other permissible distributees from any such GST Trust during such time. Therefore, pursuant to § 2651(f)(1), each GST Trust is treated as being assigned to the Third Generation. Accordingly, a transfer of shares of Company stock subjecting the GST Trust to the Agreement is treated as a transfer to a family member of no lower than the generational assignment of the parties already subject to the Agreement on Date 1.

The Agreement was adopted before October 8, 1990 and, consequently is exempt from the application of § 2703, provided the Agreement is not substantially modified as set forth in § 25.2703-1(c). No family member which is treated as having been added to the Agreement after October 8, 1990 is assigned to a lower generational assignment than the parties already subject to the Agreement on Date 1. Accordingly, based upon the information submitted and representations made, we conclude that none of the transfers of shares of Company stock subject to the Agreement after October 8, 1990, constitute

substantial modifications within the meaning of § 25.2703-1(c). Consequently, the Agreement continues to be grandfathered for purposes of chapter 14.

Ruling #2

On Date 7, a date after October 8, 1990, Company amended the Articles to change its name to the current name. On Date 8, Company amended and restated the Articles. Also on Date 8, Company amended and restated the Bylaws that included administrative changes such as name change, indemnification, and number of members constituting the Board of Directors.

Based upon the facts submitted and representations made, we conclude that none of the amendments to the Articles on Date 7, the amendments and restatement of the Articles on Date 8, and the amendment and restatement of the Bylaws on Date 8 constitute substantial modifications of any right or restriction in the Articles, the Bylaws, or the Agreement within the meaning of § 25.2703-1(c). Consequently, we conclude that the Articles, the Bylaws, and the Agreement continue to be grandfathered for purposes of chapter 14.

Ruling #3

The proposed Plan of Recapitalization includes a stock split of one share of Company common stock into one share of Class A voting common stock and $\frac{1}{2}$ shares of Class B nonvoting common stock. The Articles and Agreement will be amended to reflect the stock split and the addition of Class B nonvoting common stock to the capital structure. The issuance of the Class B nonvoting common stock does not change the terms and conditions to which the shareholders are already subject. In addition, the beneficial interest in the Company will not be affected by the stock split because each shareholder of common stock will receive $\frac{1}{2}$ shares of Class B nonvoting common stock for every share of common stock held prior to the recapitalization. Accordingly, we conclude that the recapitalization does not affect the quality, value, or timing of any rights of the parties to the Agreement.

Based upon the facts submitted and representations made, we conclude that the proposed Plan of Recapitalization, the proposed amendments to the Articles and Agreement to reflect the stock split and the addition of Class B nonvoting common stock to the capital structure, and the issuance of Class B nonvoting common stock, will not constitute substantial modifications of the Agreement or the Articles within the meaning of § 25.2703-1(c). Further, we conclude that the proposed Plan of Recapitalization and the proposed amendments, described above, will not cause § 2703 to apply to transfers of shares of Company stock subject to the Agreement, as amended.

Ruling #4

C, D and E propose to transfer shares of Class B nonvoting stock in the Company to the GST Trusts created by each. Each GST Trust is assigned to the Third Generation of family members subject to the Agreement. We concluded under Ruling 1 that the prior transfers by C of shares of Company stock to C's GST Trusts do not cause a substantial modification of the Agreement. We likewise conclude that the proposed transfers of shares of Company stock by C to her GST Trusts do not cause a substantial modification to the Agreement. Similarly, the proposed transfers by D and E of shares of Company stock to D's and E's GST Trusts, respectively, do not cause a substantial modification of the Agreement.

Accordingly, based upon the facts submitted and representations made, we conclude the proposed transfers of shares of Company stock by C, D and E to the GST Trusts created by each will not constitute substantial modifications of the Agreement within the meaning of § 25.2703-1(c). Further, we conclude that the proposed transfers of shares of Company stock by C, D and E to the GST Trusts created by each will not cause § 2703 to apply to the transfer of shares of Company stock subject to the Agreement, as amended.

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.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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.

Sincerely,

Lorraine E. Gardner

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures:

Copy for § 6110 purposes
Copy for this letter