

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

**CC:CORP:2-PLR-104071-00**

Date:

**September 28, 2000**

### LEGEND:

Corporation X =

Corporation Y =

State A =

State B =

Business =

Son =

Father =

Mother =

Trust =

c =

d =

e =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

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Date 6 =

Date 7 =

Dear:

This responds to your letter dated January 28, 2000, requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was received in letters dated June 30 and August 31, 2000. The information submitted for consideration is summarized below.

Corporation X is a State A corporation engaged in Business in State B. Corporation X has a calendar taxable year and uses the accrual method of accounting. Corporation X has outstanding a single class of voting common stock.

Corporation X was formed on Date 1. The initial shareholders of Corporation X were Son and Corporation Y. To finance his initial capital contribution to Corporation X, Son borrowed \$c from Father and Mother (jointly referred to hereafter as "Parents"), providing them with a note in exchange therefor ("Son's Note").

Parents are the grantors, trustees, and beneficiaries of Trust, which they caused to be created on Date 2. Trust is described under the grantor trust rules of subpart E of part 1 of subchapter J. On Date 3, Parents transferred Son's Note to Trust.

On Date 4, Corporation Y's interest in Corporation X was completely redeemed, leaving Son as the sole owner of all of Corporation X's outstanding stock. On Date 5 (which date is within 10 years of the proposed transaction described herein), Son caused Corporation X to transfer d shares of common stock to Trust in satisfaction of Son's Note and to encourage Father to take an active part in the business; this transaction was later determined by the Internal Revenue Service to be a sale or exchange under § 1001 of the Internal Revenue Code of Son's shares in Corporation X. As a result, Trust now owns d shares of the outstanding stock, while Son owns e shares.

Father was retained by Corporation X as a consultant for a period of five years pursuant to a consulting agreement (the "agreement") entered into on Date 6. The agreement specifically provided that Father was not engaged as an employee or in management of Corporation X. The agreement terminated on Date 7. Father no longer provides consulting services to Corporation X.

Corporation X intends to redeem all of the Corporation X stock held by Trust in exchange for a promissory note (the "Corporation X Note") and cash. The Corporation X Note and cash will have an aggregate face amount equal to the fair market value of

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the stock redeemed, bear interest at the applicable federal rate on the date of closing, and be payable in equal annual installments over no more than 15 years.

Section 453(a) provides that income from an “installment sale”, which is defined by § 453(b) as a disposition of property where at least one payment is to be received after the close of the taxable year in which the disposition occurs, shall be reported under the installment method, except as otherwise provided in § 453.

Section 453B(a) provides, in part, that if an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and the fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission or disposition otherwise than by sale or exchange.

Section 453B(f) provides that for purposes of § 453B, if any installment obligation is canceled or otherwise becomes unenforceable, the obligation shall be treated as if it were disposed of in a transaction other than a sale or exchange, and if the obligor and obligee are related persons (within the meaning of § 453(f)(1)), the fair market value of the obligation shall be treated as not less than its face amount.

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

(a) There are no outstanding options or warrants to purchase Corporation X stock, nor are there any outstanding debentures or other obligations that are convertible into Corporation X stock or would be considered Corporation X stock.

(b) In no event will the last payment on any note or other obligation be made more than 15 years after the date of issuance of the note or other obligation.

(c) None of the consideration from Corporation X, including interest, consists entirely or partly of Corporation X's promise to pay an amount that is based on, or contingent on, future earnings of Corporation X, an amount that is contingent on working capital being maintained at a certain level or any other similar contingency.

(d) Any note or other obligation to be issued to Trust or Parents will not be subordinated to the claims of general creditors of Corporation X.

(e) In the event of default on any note or other obligation, no shares of stock will revert to or be received by Trust or Parents nor will Trust or Parents be permitted to purchase the stock at public or private sale.

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(f) No shareholder of Corporation X has been or will be obligated to purchase any of the stock to be redeemed.

(g) The redemption described in this ruling request is an isolated transaction and is not related to any other past or future transaction.

(h) There have been no redemptions, issuances, or exchanges by Corporation X of its stock in the past five years.

(i) Corporation X has no plan or intention to issue, redeem, or exchange additional shares of its stock.

(j) After the redemption, neither Trust nor Parents will have any interest in Corporation X including as interest as officer, director, or employee (other than an interest as a creditor described in § 1.302-4(d) of the Income Tax Regulations, and constructive ownership under § 318(a)(1) of the Code).

(k) Trust and Parents will execute and file the agreement required by § 302(c)(2)(A)(iii) of the Code with respect to the acquisition of any interest in Corporation X within 10 years from the date of redemption.

(l) Trust and Parents and each related person will agree to be jointly and severally liable for any deficiency (including interest and additional tax) resulting from an acquisition of an interest in Corporation X within 10 years from the date of redemption.

(m) None of the stock to be redeemed is "section 306 stock" within the meaning of § 306(c) of the Code.

(n) There are no declared but unpaid dividends, or funds set apart for dividends, on any of the stock to be redeemed.

(o) At the time of the exchange, the fair market value of the consideration to be received by Trust and Parents will be approximately equal to the fair market value of the Corporation X's stock to be exchanged therefor.

(p) The price to be paid for Corporation X's stock to be redeemed will not result in a loss with respect to those shares of stock.

(q) The redemption of Corporation X stock (i) is 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 required to be included in the inventory of any redeemed shareholder at the close of the taxable year. Any note or other obligation to be issued to a

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redeemed shareholder will not be issued in any form designed to render it readily tradeable on an established securities market.

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

(1) The transfer of shares of Corporation X stock to Trust, as described above, did not have as one of its principal purposes the avoidance of federal income tax within the meaning of § 302(c)(2)(B).

(2) Provided that Trust and Parents execute and file the agreement described in § 302(c)(2)(A)(iii) in accordance with § 1.302-4(a), and the conditions in § 302(c)(2)(A)(i) and (ii) are satisfied, the redemption by Corporation X of all the shares of its stock held by Trust will constitute a complete termination of Parents' interest within the meaning of § 302(b)(3). The amount distributed in the redemption will be treated as a distribution in full payment in exchange for the stock redeemed as provided in § 302(a). Pursuant to § 302(c)(2), § 318(a)(1) will not apply to the proposed transaction.

(4) As provided in § 1001, Parents will realize and recognize gain on the redemption of the Corporation X stock, measured by the difference between the redemption price and the adjusted basis of the shares of Corporation X stock surrendered as determined under § 1011. Provided that § 341 (relating to collapsible corporations) is not applicable and the Corporation X stock is a capital asset in the hands of Parents, the gain will constitute capital gain subject to the conditions and limitations of Subchapter P of Chapter 1 of the Code. Pursuant to the provisions of § 267, no loss will be allowable.

(5) Unless Parents elect out of the installment method, they shall report the gain realized from the redemption of the Corporation X stock for the cash and Corporation X Note on the installment method pursuant to the provisions of §453. The amount of income that Parents shall recognize for any taxable year with respect to the Corporation X Note will be that proportion of the payments received in such year which the gross profit (realized or to be realized when payments are completed) bears to the contract price (the total redemption price less the amount of indebtedness, if any, to which the Parents' Corporation X stock is subject). Such gross profit will be the sales price (total redemption price) less the adjusted basis, as determined under § 1011, of the shares redeemed. In addition, any interest income received or made available is includible in Parents' gross income under § 61. If the Corporation X Note is canceled or otherwise becomes unenforceable, the amount of income recognized by Parents will be determined in accordance with the provisions of §453B.

(6) Son will not receive a constructive dividend as a result of the redemption of all the Corporation X stock held by Trust (Rev. Rul. 69-608, 1969-2 C.B. 42; Rev. Rul. 58-614, 1958-2 C.B. 920).

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No opinion is expressed about the tax treatment of the above transactions under other provisions of the Code and 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. In particular, no opinion is expressed with respect to the tax treatment of the excess, if any, of the fair market value of the Corporation X stock to be exchanged by Trust over the sum of the cash and fair market value of the Corporation X Note to be received. Similarly, no opinion is expressed regarding the tax treatment of the excess, if any, of the sum of the cash and the fair market value of the Corporation X Note to be given Trust over the fair market value of the Corporation X stock to be transferred to Corporation X by Trust.

In addition, no opinion is expressed as to whether the Corporation X Note is debt or equity because the determination is primarily one of fact (§ 4.02(1) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 111).

This ruling is directed only to the taxpayer(s) 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 should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to the taxpayer's authorized representative.

Sincerely,  
Assistant Chief Counsel (Corporate)  
By: Lewis K. Brickates  
Assistant to Chief, Branch 2