

## Internal Revenue Service

## Department of the Treasury

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State X =

Date 1 =

Date 2 =

Year 1 =

Business A =

Corporation =

Taxpayer =

Husband =

Son #1 =

Son #2 =

Daughter =

Employee =

\$Y =

\$Z =

a =

b =

c =

d =

Dear :

We respond to your letter dated July 15, 1999, in which you requested rulings under section 302(b)(3) of the Internal Revenue Code on behalf of Taxpayer. The information submitted in that letter and later correspondence is summarized below.

Corporation, a State X company, uses the accrual method of accounting and files its returns on a fiscal year ending on Date 1. Corporation is primarily involved in Business A. Currently, Corporation currently has 950 shares of voting common stock outstanding which are owned as follows:

<u>Shareholder</u>	<u>Number of shares owned</u>
Taxpayer	510
Husband	74
Daughter	122
Son #1	122
Son #2	122

Husband is the husband of Taxpayer. Son #1, Son #2, and Daughter are their children. Since the inception of Corporation in Year 1 and until now, all of the shareholders have been employees of Corporation. Currently, Taxpayer is the President of Corporation; Husband is the General Manager and Secretary; Son #1 is the Field Superintendent & Corporate Treasurer; Son #2 is the Project Manager, Estimator and Corporate Vice-President; and Daughter is the Office Manager & Corporate Vice-President. During the immediately preceding 10-year period, Taxpayer made gifts of a shares of Corporation stock to each of her children, Husband made a gift of b shares of Corporation stock to Taxpayer, and Husband made gifts of c shares of Corporation stock to Daughter and Son #2, and of d shares of Corporation stock to Son #1. The gifts from Taxpayer and Husband to the children were made to encourage the children's interest in the business and as part of their overall estate planning.

Taxpayer now desires to retire from Corporation and to have Corporation redeem all of her shares for cash, at approximately \$Y per share. The redeemed shares will be held as treasury stock. Following the redemption, the shares of Corporation stock will be held as follows:

<u>Shareholder</u>	<u>Number of shares held</u>
Husband	74

Daughter	122
Son #1	122
Son #2	122

Following the redemption, the remaining shareholders will continue their employment with Corporation and Corporation will continue to lease its facilities from Husband. Taxpayer will also remain entitled to benefits arising out of Corporation's qualified plans and will continue to be covered, as a dependent of Husband, under Corporation's health insurance plans. Taxpayer will also continue as a guaranty of Corporation's indebtedness to its commercial lender and Husband will continue to make gifts of stock to his children.

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

- (a) Except for the shares of common stock set forth above, there are no other shares of common stock or shares of any class outstanding. Furthermore, there are no outstanding options or warrants to purchase any stock in Corporation, nor are there any outstanding debentures or other obligations that are convertible into Corporation stock or would be considered Corporation stock.
- (b) No notes or other obligations of Corporation will be distributed to a redeemed shareholder.
- (c) The redemption described in the ruling request is an isolated transaction and is not related to any past or future transactions.
- (d) Except for 50 shares of common stock which were redeemed from Employee on Date 2 for a purchase price of \$Z, there have been no redemptions, issuances, or exchanges by Corporation of its stock in the past five years. None of the stock owned by Employee would be deemed constructively owned by Taxpayer or any member of her family.
- (e) Throughout the 10-year period, following the redemption, Taxpayer will not have any interest in Corporation, including an interest as an officer, director or employee (other than an interest under the constructive ownership rules pursuant to section 318(a)(1) of the Code).
- (f) Except for the redemption of Taxpayer's shares of stock in Corporation, as described above, Corporation has no plan or intention to issue, redeem or otherwise exchange any shares of its stock.
- (g) The taxpayer will execute and file the agreement required by section 302(c)(2)(A)(iii) of the Code with respect to the acquisition, within ten years from

the date of the redemption, of any interest in Corporation.

- (h) No shareholder of Corporation has been or will be obligated to purchase any of Taxpayer's shares of stock to be redeemed.
- (i) None of Taxpayer's shares to be redeemed is "section 306 stock" within the meaning of section 306(c).
- (j) There are no declared but unpaid dividends, or funds set aside for dividends, on any of the shares of stock to be redeemed.
- (k) At the time of the redemption, the fair market value of the consideration to be received by Taxpayer will be approximately equal to the fair market value of Corporation's stock to be surrendered by Taxpayer in exchange therefor.
- (l) The price to be paid for Corporation's shares of stock to be redeemed will not result in a loss with respect to those shares of stock.

Based on the information submitted and on the representations set forth above, we rule as follows:

- (1) The gifts of Corporation stock by Taxpayer to her three children, and the gift of Corporation stock by Husband to Taxpayer, did not have as one of their principal purposes the avoidance of federal income tax within the meaning of section 302(c)(2)(B) (Rev. Rul. 77-293, 1977-2 C.B. 91; Rev. Rul. 79-67, 1979-1 C.B. 128).
- (2) Provided that Taxpayer files the agreement described in section 302(c)(2)(A)(iii) in accordance with section 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 of all of Taxpayer's shares of Corporation stock will be a "complete termination" of Taxpayer'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, Taxpayer will realize and recognize gain on the redemption of the Corporation shares of stock. For each share of stock surrendered, gain will be measured by the difference between the redemption price and the adjusted basis of such share as determined under section 1011. Provided that section 341 (relating to collapsible corporations) is not applicable and Corporation stock is a capital asset in the hands of Taxpayer, the gain will constitute capital gain subject to the conditions and limitations of Subchapter P of Chapter 1 of the Code.

No opinion is expressed about the tax treatment of the proposed transaction 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 proposed transaction that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6610(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,  
Assistant Chief Counsel (Corporate)  
By: Mark S. Jennings  
Acting Branch Chief, CC:DOM:CORP:1