

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:DOM:P&SI:3 PLR-101056-00  
Date:  
April 26, 2000

Company:

State:

M:

N:

P:

Formula A:

Formula B:

a:

b:

c:

Dear

This letter responds to a letter from M dated January 4, 2000, requesting a ruling that the restrictions placed on Company's nonvoting common stock by an employment agreement (the "Agreement") will not cause Company to have a second class of stock under § 1361(b)(1)(D) of the Internal Revenue Code. Company represents the following facts.

Company, a State corporation, is owned by M, N, and P. Company elected under § 1362(a) to be an S corporation effective a.

P entered into the Agreement with Company effective b. As part of the

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Agreement, P was given Company common stock, consisting of nonvoting shares.

The Agreement provides that Company is obligated to buy P's stock if certain events occur. By formula, a higher stock purchase price is provided for "nonvoluntary" events than for "voluntary" ones. Nonvoluntary events include death or disability, divorce, termination of employment by Company without just cause, or termination of employment by P with just cause. Voluntary events include termination of employment by P without just cause or termination of employment by Company with just cause.

Upon the occurrence of a nonvoluntary event, Company must buy P's stock for a price that reflects the parties' good faith determination of fair market value. This price is determined by Formula A.

Upon the occurrence of a voluntary event, P will receive a price that reflects only the increase in shareholders' equity since c. This price is determined by Formula B.

The agreement does not affect the amount of dividend distributions or liquidation proceeds, which is the same for all shareholders. Company represents that the Agreement is a commercial contract negotiated at arm's length between unrelated parties as part of the terms of employment of a key Company officer. Company further represents that it is not a principal purpose of the Agreement to circumvent the single-class-of-stock requirement of § 1361(b)(1)(D).

Section 1361(b)(1)(D) provides that for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not, among other things, have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that, except as provided in § 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding

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agreement relating to distribution and liquidation proceeds and, thus, is not a governing provision unless a principal purpose of the agreement is to circumvent the one class of stock requirement of § 1361(b)(1)(D).

Section 1.1361-1(l)(2)(iii)(B) provides that bona fide agreements to redeem or purchase stock at the time of death, divorce, disability, or termination of employment are disregarded in determining whether a corporation's shares of stock confer identical rights.

Based solely on the facts as represented by Company in its request, we rule that the restrictions placed on the nonvoting common stock by the Agreement will be disregarded in determining whether Company's shares of stock confer identical rights.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. In particular, no opinion is expressed on whether Company meets the other requirements of § 1361.

In accordance with the power of attorney on file with this office, we are sending you the original of this letter, with copies to the taxpayer and the taxpayer's other authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,  
JONI LARSON  
Acting Assistant to the Chief, Branch 3  
Office of Assistant Chief Counsel  
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes