

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

Refer Reply To:  
CC:ITA:B04  
PLR-100198-06  
Date:  
August 03, 2007

Shareholder E =

Corporation =

Date A =

Date B =

Month C =

Dear \_\_\_\_\_ :

This responds to your request dated December 27, 2005 for rulings regarding certain Federal income tax consequences of a proposed transaction. The facts as provided in that request and in later correspondence are summarized below.

Corporation is a domestic corporation that was formed on Date A and whose stock is publicly traded. As part of its plan of formation, Corporation entered into certain arrangements with 12 individuals, including Shareholder E, that included the receipt of Corporation shares (the "Shares") by each of these 12 individuals.

The Shares were issued to the 12 Shareholders on Date B, at which time Corporation's stock was not yet publicly traded. In Month C, Corporation issued stock of the same class held by the 12 Shareholders to the public.

In connection with the issuance of the Shares to the 12 Shareholders, as described above, each of the 12 Shareholders executed, pursuant to a Loan and Security Agreement (collectively, the "Loan Agreements"), a non recourse note payable to Corporation (singularly, a "Note" and collectively, the "Notes"). The total amount of each Note was equal to the total federal, state, and local withholding and payroll taxes attributable to the issuance of the Shares that Corporation paid to the Internal Revenue Service and to the state tax authorities on behalf of each of the 12 Shareholders. The interest rate on each Note was the applicable federal rate at the time of issuance. The Loan Agreements provided that Corporation could foreclose on the Shares in full satisfaction of the Notes owed to it by the 12 Shareholders. The Loan Agreements and the Notes were subsequently amended in part, but the amendments did not alter Corporation's right to foreclose on the Shares in satisfaction of the Notes owed it by the 12 Shareholders. The Notes currently remain outstanding.

Corporation now proposes to demand payment of each Note and to accept the Shares of each of the 12 Shareholders in satisfaction of the shareholder's Note.

Shareholder E and several other of the 12 Shareholders will surrender all of their Shares to Corporation in satisfaction of the respective Note owed by each of them to Corporation. In your request, you asked whether the transfer of all of the Shares by Shareholder E to Corporation in satisfaction of the Note owed by Shareholder E to Corporation should be treated as a redemption under § 302, and if so, whether Shareholder E would be entitled to exchange treatment under § 302(b)(3) in the redemption.

Shareholder E made certain representations regarding the surrender of the Shares to Corporation. The representations made are as follows:

- (a) No notes or other obligations of Corporation will be distributed to Shareholder E, or any other shareholder in the proposed transaction.
- (b) No shareholder of Corporation has been or will be obligated to purchase any of the stock to be surrendered by Shareholder E or any other shareholder in the proposed transaction.
- (c) The proposed redemptions from Shareholder E and the other shareholders are isolated transactions and are not related to any other past or future transaction.
- (d) Corporation has no plan or intention to issue, redeem, or exchange additional shares of its stock (other than in the normal course of business) following the proposed transaction.

- (e) Shareholder E is not related, within the meaning of § 318, to any remaining shareholders of Corporation. Following the proposed redemptions, there will be no Corporation stock constructively owned by Shareholder E within the meaning of § 318.
- (f) None of the stock to be redeemed from Shareholder E is “§ 306” stock within the meaning of § 306(c) of the Code.
- (g) There are no declared but unpaid dividends, or funds set apart for dividends, on any of the Corporation stock to be redeemed from Shareholder E in the proposed transaction.
- (h) Shareholder E will not own any options, restricted stock units, debentures, or other obligations or rights that would allow Shareholder E to acquire Corporation stock after the proposed redemption.
- (i) After the proposed redemption, Shareholder E will not have any interest in Corporation, including an interest as an officer, director, or employee.

Based solely on the information submitted and representations made, and provided that the Note executed by Shareholder E to Corporation qualifies as debt for federal income tax purposes, we rule as follows:

(1) The surrender by Shareholder E of Shareholder E's Shares in cancellation of the Note owed by such shareholder to Corporation will be tested as a redemption under § 302.<sup>1</sup> Since Shareholder E will surrender all of Shareholder E's Corporation Shares in the transaction, Shareholder E will be entitled to treat the redemption as a complete termination of interest under § 302(b)(3) of the Code. The amounts distributed to Shareholder E will be treated as a distribution in part or full payment in exchange for the Shares surrendered as provided in § 302(a).<sup>2</sup>

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<sup>1</sup> See Tabery v. Commissioner, T.C.M. 1964-189, aff'd 354 F.2d 422 (9th Cir. 1965) (surrender of stock by a shareholder to his corporation in satisfaction of a debt owed to the corporation by the shareholder tested as a redemption under § 302); McGinty v. Commissioner, 325 F.2d 820 (2<sup>nd</sup> Cir, 1963) (same); Bradbury v. Commissioner, 298 F.2d 111 (1<sup>st</sup> Cir, 1962) (same); § 317(b) (stock shall be treated as redeemed if acquired from a shareholder in exchange for “property”); § 1.317-1 (the term “property” includes an indebtedness owed to the corporation).

<sup>2</sup> Where a redemption qualifies via § 302(a) for exchange treatment, the amount of gain or loss which the shareholder realizes on the exchange is computed pursuant to § 1001(a) and (b). In computing the realized and recognized gain, the shareholder offsets his or her basis in the redeemed shares against the sum of cash plus the fair market value of property (other than cash) which he or she receives. Where a shareholder realizes a loss on a redemption which is treated as an exchange under § 302, the rules of § 267 may cause the loss to be nondeductible.

(2) Shareholder E will recognize gain or loss on the surrender of Corporation stock in cancellation of the nonrecourse Note owed by Shareholder E to Corporation equal to the amount realized on the cancellation less Shareholder E's basis in the surrendered stock. The amount realized includes the amount of liabilities secured by the surrendered stock. §§ 1.1001-2(a)(1) and (a)(4)(i).

(3) Because Shareholder E has held the surrendered Corporation stock for more than one year, the gain or loss recognized under ruling (2) above will be long term capital gain or loss. §§ 1222(3) and 1222(4).

We express no opinion about the tax treatment of the above-described transactions under other provisions of the Code and regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the above-described transactions that are not specifically covered by the above ruling. In particular, we express no opinion regarding:

- (i) whether the Note executed by Shareholder E will qualify as debt for federal income tax purposes;
- (ii) the federal income tax consequences to Corporation on the redemptions of the Shares from Shareholder E;
- (iii) whether § 267 applies to the redemptions of the Shares from Shareholder E;
- (iv) whether any modification of the Note constitutes a disposition of the Note pursuant to § 1.1001-3 of the regulations.

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. This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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If a shareholder surrenders stock to a corporation for less than its fair market value, such surrender may be a gift or compensation to the shareholders who remain interested in the corporation. Conversely, if a corporation pays more than fair market value for its stock, the payment may be compensation to the shareholder surrendering stock or may be a gift to him or her from the shareholders who remain interested in the corporation. See Rev. Rul. 58-614, 1958-2 C.B. 920.

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter showing the deletions proposed to be made when it is disclosed under § 6110. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

George F. Wright  
Senior Technician Reviewer, Branch 5  
Office of Associate Chief Counsel  
(Income Tax & Accounting)