Internal Revenue Service

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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:B03
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Date:
March 29, 2019

Legend

X =

Date 1 =

Date 2 =

Date 3 =

State 1 =

State 2 =

State 3 =

A =

B =

Y =

N1 =

N2 =

N3 =

N4 =

N5 =

Agreement 1 =

Agreement 2 =

Dear :

This letter responds to a letter dated September 28, 2018, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1361 of the Internal Revenue Code.

FACTS

The information submitted states that X was formed under the laws of State 1 and elected to be treated as an S corporation effective Date 1. X subsequently changed its place of organization from State 1 to State 2.

At all relevant times, X had one shareholder, A, an individual. X engaged another individual, B, through a State 3 corporation, Y, in marketing various business services and products to its merchant clients. On Date 2, X, A, B, and Y entered into Agreement 1, which provided for the sale of N1 percent of the stock of X held by A upon the satisfaction of certain conditions. On Date 3, X, A, B, and Y terminated Agreement 1 at a time when no stock had been transferred pursuant to Agreement 1 and entered into Agreement 2, which provided B with certain payment rights upon the occurrence of a Liquidity Event. Under the terms of Agreement 2, a Liquidity Event generally included a sale of a majority of X's assets, the transfer of rights to control over any use of all or substantially all of X's assets under a lease, exchange, license or similar agreement, a merger or consolidation in which X's shareholders own less than 50% of the voting securities of the surviving company or an IPO of X stock.

Agreement 2 contemplated that X, A, B, and Y may agree to a buy-out of B's rights under Agreement 2 prior to the occurrence of a Liquidity Event. In the case of a buy-out, N2 percent of the amount owed was to be paid within N3 days of the determination of the amount owed and the remainder was payable in equal monthly installments over N4 months, including N5 percent interest on the outstanding balance. Monthly installment payments were to be secured by a pledge of not less than N1 percent of the X stock held by A.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines the term "small business corporation" as a domestic corporation that is not an ineligible corporation and that, among other things, does not have more than one class of stock.

Section 1.1361-1(b)(4) of the Income Tax Regulations provides that, for purposes of Subchapter S, an instrument, obligation, or arrangement is not outstanding stock if it: (i) does not convey the right to vote; (ii) is an unfunded and unsecured promise to pay money or property in the future; (iii) is issued to an individual who is an employee in connection with the performance of services for the corporation or to an individual who is an independent contractor in connection with the performance of services for the corporation (and is not excessive by reference to the services performed); and (iv) is issued pursuant to a plan with respect to which the employee or independent contractor is not taxed currently on income.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that Agreement 1 and Agreement 2 satisfy the requirements of §1.1361-1(b)(4). Accordingly, Agreement 1 and Agreement 2 are not considered outstanding stock, and X's S corporation election was not terminated by virtue of the existence of Agreement 1 or Agreement 2.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code.

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

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes