

**Internal Revenue Service**

**Department of the Treasury**

Number: **200122024**

Release Date: 6/1/2001

Index Nos.: 2703-00.00

**Washington, DC 20224**

**Person to Contact:**

**Telephone Number:**

**Refer Reply To:**

CC:PSI:7:PLR-100554-00

**Date:**

February 27, 2001

Legend: Corporation:

State:

Date 1:

Date 2:

Date 3:

Date 4:

Taxpayer 1:

Taxpayer 2:

Date 5:

Date 6:

Dear :

We received a letter dated December 14, 1999, from your authorized representative requesting rulings on behalf of Corporation concerning the application of § 2703 of the Internal Revenue Code to certain amendments to Corporation's Articles of Incorporation. This letter responds to that request.

The facts and representations submitted are as follows. The Articles of Incorporation for Corporation were filed originally in State on Date 1. Corporation is a family-owned corporation taxable as an "S" corporation for federal income tax purposes. Corporation is owned by related individual shareholders and certain other trusts.

The Articles of Incorporation contain buy-sell provisions restricting the transfer of Corporation's voting and non-voting stock. Generally, the Corporation has a right of first refusal before any transfer of record or beneficial ownership of Corporation's stock can be made, for any reason.

On Date 2, the Internal Revenue Service issued to Corporation a private letter ruling approving several amendments to Corporation's Articles of Incorporation. After

receiving the Date 2 letter ruling, Corporation amended its Articles of Incorporation on Date 3. Corporation made additional amendments to the Articles of Incorporation on Date 4 and Date 5. On Date 6, Corporation drafted additional amendments that are proposed to be effective if Corporation receives a private letter ruling approving the amendments.

#### Date 4 Amendment

On Date 4, Corporation amended Article 4.4 of its Articles of Incorporation to remove the following provision:

...the personal representative of any deceased share holder born prior to 1930 shall sell, and [Corporation] or its assignee shall buy, on one or more transactions, in accordance with the procedures and terms provided in the bylaws and at the fair market value last determined according to Article 4.5 and in accordance with terms provided in the bylaws, the maximum number of shares of voting and nonvoting common stock that will permit the purchase price to be treated, for federal income tax purposes, as a distribution in full payment in exchange for the shares redeemed by [Corporation] or its assignee...

Corporation represents that this restriction was removed from the Articles of Incorporation because there were no shareholders born prior to 1930 then living. Corporation further represents that the purpose of the mandatory sale provision was to require ownership of shares to stay within a certain class of individuals, specifically, lineal descendants of Taxpayer 1 and Taxpayer 2. In light of existing transfer restrictions already contained in the Articles of Incorporation, Corporation determined this provision was unnecessary.

#### Date 5 Amendments

On Date 5, several amendments were made to the Articles of Incorporation:

(a) Prior to Date 5, Corporation had redeemed all callable preferred stock. On Date 4, Corporation deleted all references to nonvoting callable preferred stock in its Articles of Incorporation. Corporation represents that no preferred stock was outstanding at the time of the amendment.

(b) Corporation amended its right of first refusal provisions to exempt certain intra-family transfers from those provisions. Specifically, the following transfers may take place without first offering to sell such shares to Corporation:

(i) any transfer of shares of voting or nonvoting common stock without consideration resulting from a change in custodian for a minor child or a change in

trustee of any trust which does not result in a change in the beneficial owner of the shares;

(ii) any transfer of shares of voting or nonvoting common stock without consideration to a lineal descendant; or,

(iii) any transfer of nonvoting common stock without consideration to a trust for the benefit of the transferring shareholder's spouse.

(c) In addition, on Date 5, Corporation amended the first paragraph of Article V to delete the names of the then-acting directors of Corporation.

#### Date 6 Amendments

On Date 6, Corporation further amended its Articles of Incorporation in the following manner:

(a) Corporation revised Article III to reflect the new address for Corporation;

(b) Corporation corrected the number of authorized shares stated in Article 4.1(a). Corporation represents that the number of authorized shares was incorrectly stated in the Date 5 Amended Articles of Incorporation;

(c) Corporation revised Article 4.1(a) to specify that the term "lineal descendants" includes any adopted child who was adopted prior to the age of eighteen. Under State law, the term "descendants" includes adopted children;

(d) Corporation amended Article 4.3(a) to include a reference to the statutory right of shareholders owning nonvoting stock to vote in certain limited instances. The first sentence of Article 4.3(a) was amended to read as follows:

The right to vote in the management and affairs of [Corporation] is vested solely in the voting common stock except for such voting rights as are reserved for nonvoting common stock by law;

(e) Corporation amended Article 4.4 to exempt from the transfer restriction "any transfer of non-voting common stock to a spouse of a lineal descendant shareholder if the spouse had previously received shares as a result of a transfer that complied in all ways with the transfer limitations imposed by [the Articles of Incorporation]."

(f) Corporation amended Article V to update provisions for officers and directors that currently exist under State law. These amendments require officers and directors to discuss any related transactions between themselves, indicate that any

interested director is to abstain from voting on a matter in which he or she has a personal interest and update the indemnification paragraph to reflect current state statutes;

(g) Corporation amended its Articles of Incorporation to reference the power of the shareholders to amend the bylaws under State law;

(h) Corporation added Article VIII to the Articles of Incorporation. That Article provides:

the right to cumulate votes in the election of directors shall not exist with respect to shares of stock of [Corporation];

Under State law, unless otherwise provided in the Articles of Incorporation, shareholders entitled to vote at any election of directors are entitled to cumulate votes by multiplying the number of votes they are entitled to cast by the number of directors for whom they are entitled to vote and to cast the product for a single candidate or distribute the product among two or more candidates.

Corporation represents that the shareholders' practice has always been not to cumulate votes with respect to voting on Directors, and that the amendment simply reflects a long-standing practice of shareholders.

(i) Corporation added Article IX regarding shareholder actions. This Article reflects current State law that gives shareholders the right to take action without the necessity of calling a meeting. The Articles provide that shareholders may take action without calling a meeting if either:

(i) the action is taken by all shareholders entitled to vote on the action;  
or,

taken by (ii) so long as [Corporation] is not a public company, the action is shareholders holding of record, or otherwise entitled to vote, in the aggregate, not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote on the action were present and voted.

The Articles of Incorporation further provide that any action taken without a unanimous shareholder consent requires a further determination by the Board of Directors that:

(i) The matter being submitted for shareholder approval is more a ministerial than a substantive matter; (ii) an opportunity for shareholder discussion is not of sufficient importance as to require a shareholder meeting; and, (iii) all reasonable efforts have been taken to obtain a

unanimous shareholder consent and that those efforts were not successful.

Corporation represents that the above provisions were added in order to permit Corporation to avail itself of a new provision in State law intended to facilitate the ability of a closely-held corporation to take action.

Corporation requests rulings that the post-Date 3 amendments to the Articles of Incorporation (i) do not constitute "substantial modifications" for purposes of § 25.2703-1(c) and (ii) consequently, Corporation's Articles of Incorporation continue to be grandfathered for purposes of Chapter 14 of the Code.

Section 2703(a) provides that, for purposes of the estate, gift, and generation-skipping transfer taxes, the value of any property is determined without regard to 1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or 2) any restriction on the right to sell or use such property.

Under Public Law 101-508, § 11602(e)(1)(A), § 2703 applies to agreements, options, rights, or restrictions entered into or granted after October 8, 1990, and agreements, options, rights, or restrictions which are substantially modified after that date.

Section 25.2703-1(c)(1) provides that a right or restriction that is substantially modified is treated as a right or restriction created on the date of the modification. Any discretionary modification of a right or restriction, whether or not authorized by the terms of the agreement, that results in other than a de minimis change to the quality, value, or timing of the rights of any party with respect to property that is subject to the right or restriction is a substantial modification. If the terms of the right or restriction require periodic updating, the failure to update is presumed to substantially modify the right or restriction unless it can be shown that updating would not have resulted in a substantial modification. The addition of any family member as a party to a right or restriction (including by reason of a transfer of property that subjects the transferee family member to a right or restriction with respect to the transferred property) is considered a substantial modification, unless the addition is mandatory under the terms of the right or restriction or the added family member is assigned to a generation (determined under the rules of section 2651) no lower than the lowest generation occupied by individuals already a party to the right or restriction.

Section 25.2703-1(c)(2) provides that a substantial modification does not include: (1) a modification required by the terms of a right or restriction; (2) a discretionary modification of an agreement conferring a right or restriction if the modification does not change the right or restriction; (3) a modification of a capitalization rate used with respect to a right or restriction if the rate is modified in a manner that bears a fixed relationship to a specified market interest rate; and (4) a

modification that results in an option price that more closely approximates fair market value.

#### Date 4 Amendment

In the present case, the provision deleted from the Articles of Incorporation was inapplicable to any existing shareholders of Corporation or was otherwise repetitive of existing provisions in the Articles of Incorporation. Based on the facts submitted and the representations made, we conclude that the Date 4 amendment to the Articles of Incorporation does not constitute substantial modifications for purposes of § 25.2703-1(c)(1) and does not affect the grandfathered status of the Articles of Incorporation.

#### Date 5 Amendments

(a) Based on the facts submitted and the representations made, we conclude that the amendment (a) regarding deletion of all references to nonvoting callable preferred stock was administrative in nature. Consequently, we conclude that this amendment was not a substantial modification for purposes of § 25.2703-1(c)(1) and does not affect the grandfathered status of the Articles of Incorporation.

(b) Based on the facts submitted and the representations made, we conclude that the amendments (b)(i), (ii) and (iii) regarding the transfer restrictions and right of first refusal provisions, and any transfer of shares to certain transferees represents only a de minimis change to the quality, value, or timing of the rights of the parties and does not affect the grandfathered status of the Articles of Incorporation.

(c) Based on the facts submitted and the representations made, we conclude that the amendment (c) regarding the deletion of the names of the then-acting directors from the Articles of Incorporation is administrative in nature. Consequently, we conclude that the amendment is not a substantial modification for purposes of § 25.2703-1(c) and does not affect the grandfathered status of the Articles of Incorporation.

#### Date 6 Amendments

In the present case, the Date 6 amendments (a) and (b) were made to reflect the new address of Corporation, and to correct a scrivener's error. The Date 6 amendment (c) reflects the State law that includes adopted children in the term "lineal descendants." The Date 6 amendments (d), (f), (g), and (i) merely reference rights that currently exist under State law and consequently confer no additional rights or restrictions upon the shareholders of Corporation. The Date 6 amendment (e) exempts from the transfer restrictions transfers to any shareholder who is married to a lineal descendant and who received shares previously as the result of a transfer that complied in all ways with the transfer limitations. Finally, the Date 6 amendment (h) merely reflects current shareholder practice not to cumulate votes with respect to voting

on directors, so the amendment does not effect a change. Based on the facts submitted and the representations made, we conclude that the Date 6 amendments (a),( b),(c),(d),(e),(f),(g),(h) and (i) are not substantial modifications of the shareholder agreement pursuant to § 25.2703-1(c) and do not affect the grandfathered status of the Articles of Incorporation.

Except as we have ruled herein, we express or imply no opinion concerning the tax consequences of the proposed transaction under the cited provisions or under any other provisions of the Code. Specifically, we express no opinion on the qualification of Company as a qualified S corporation.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions in this ruling take effect, the ruling will have no force or effect.

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

Sincerely,  
Christine E. Ellison  
Chief, Branch 7  
Office of the Associate Chief Counsel  
Passthroughs and Special Industries

Enclosures:  
Copy for § 6110 purposes