

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:BR05 – PLR-105080-11

Date:

August 02, 2011

In Re:

LEGEND:

Taxpayer =

Company A =

State M =

Amounts:

k = \$

l = \$

m = \$

n1 = \$

n2 = \$

o =

p =

r =

s =

Dates:

1 =

2 =

3 =

4 =

5 =

Dear

This is in response to your authorized representative's letter of January 21, 2011, and other correspondence and submissions, in which he requested on your (sometimes herein "the Taxpayer") behalf a private letter ruling regarding the proper federal income

tax treatment of a certain proposed transaction, more fully discussed below. We are pleased to address your concerns.

FACTS

The information submitted indicates that Taxpayer is the Chief Executive Officer of A, a State M corporation engaged in business-to-business brand marketing activities. Taxpayer was the sole shareholder of A, owning o shares of A common stock. As part of Taxpayer's business succession planning, Taxpayer agreed to sell p shares of A common stock, in varying portions, to 5 company A employees ("New Shareholders"). The total purchase price of the p shares of A common stock, at \$n1 per share, was to be \$l.

On or about Date 1, the New Shareholders, individually, entered into Stock Purchase Agreements with Taxpayer for the purchase and sale of their respective number of shares at \$n1 per share, executed Promissory Notes for the stated principal amounts in favor of Taxpayer at a stated interest rate of r% per annum, and executed Stock Pledge Agreements in favor of the Taxpayer. Taxpayer sold the p shares of A common stock to the New Shareholders in accordance with the terms of the Stock Purchase Agreements. Pursuant to the Promissory Notes, each New Shareholder was to pay Taxpayer: (i) nine consecutive equal annual payments of principal and interest on the outstanding principal balance, at the r% interest rate, amortized over a period of 10 years, on the last day of each August, beginning on Date 2, and (ii) a final payment of the outstanding principal balance of the Promissory Note, and all accrued interest, and any other sums payable by a New Shareholder pursuant to the Promissory Note, on Date 3.

It was the intent of the New Shareholders that a portion of Company A's annual distributions to its shareholders would be used to make the payments due to Taxpayer under the Promissory Notes. However, because of unanticipated economic downturn commencing in the year of the sale, A experienced, and continues to experience, financial difficulties. As a result, the New Shareholders were only able to make their initial payments due Taxpayer under the Promissory Notes (\$k) with distributions from A. Taxpayer believes that the present value of the p shares sold to the New Shareholders is only \$m.

Taxpayer desires to amend the terms of the Promissory Notes and Stock Purchase Agreements at issue herein to, *inter alia*: (i) reduce the Purchase Price to \$m, or \$n2 per share; (ii) reduce the interest rate under the Promissory Notes to (A) s% for the period of time from Date 1 to the date of amendment and (B) the lower of s% or the then lowest Applicable Federal Rate for the period of time from the date of amendment forward, and (iii) modify the annual payments due under the Promissory Notes as follows: (A) one installment of principal and interest in the aggregate amount of \$k due and paid on Date 2, (B) nine consecutive equal annual payments of principal

and interest on the outstanding principal balance, at the interest rate as amended, amortized over a period of 10 years, on the last day of each August, beginning on Date 4, and (C) a final payment of the entire outstanding principal balance of the Promissory Note, and all accrued interest, and any other sums payable by the New Shareholders to Taxpayer pursuant to the Promissory Notes, on Date 5.

Taxpayer requests a ruling that the described modification of the terms of the Promissory Notes and the Stock Purchase Agreements (by reducing the Purchase Price and Interest Rate, and modifying the payment dates) is not a disposition or satisfaction of an installment obligation within the meaning of section 453B(a) of the Code.

LAW & ANALYSIS

Section 453 of the Code provides that income from an installment sale shall be taken into account under the installment method. Under the installment method, a portion of the total gross profit from an installment sale is included in income in each year in which the seller receives payment.

Section 453B(a) provides that if an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or (2) the fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange. In short, if an installment obligation is satisfied at its face value or if it is "distributed, transmitted, sold, or otherwise disposed of," the seller must recognize gain or loss at that time.

The issue in this case is whether the modification of the Promissory Notes and Stock Purchase Agreements is a disposition or satisfaction of an installment obligation within the meaning of section 453B.

The Commissioner has ruled that certain modifications of the terms of an installment obligation do not amount to a disposition of the obligation. In Rev. Rul. 68-419, 1968-2 C.B. 196, the parties agreed to modify the terms of a note so that each installment of principal due by the original terms of the note would be deferred for a period of five years. In addition, the rate of interest was increased from six percent to seven percent per annum. Rev. Rul. 68-419 specifically holds that "the modification of the terms of a purchaser's note (by deferring the dates of payment of principal and increasing the rate of interest) is not a disposition or satisfaction of an installment obligation" within the meaning of section 453(d), the predecessor of current section 453B. See, also, Rev. Rul. 55-429, 1955-2 C.B. 252, reaching similar results.

In Rev. Rul. 75-457, 1975-2 C.B. 196, a taxpayer sold real estate to an individual for cash, a deed of trust, and a promissory note providing for monthly payments over a 15-year term. The terms of the deed and note allowed the individual to resell the property, provided that the subsequent buyer executed a new note under the same terms and conditions as the original deed of trust. The original obligor subsequently sold the property to a successor individual who assumed the obligation by executing a new deed of trust and note in favor of the taxpayer under the same terms and conditions as the original deed of trust and note. The original obligor was released from liability on the original note. Rev. Rul. 75-457 holds that the substitution of obligors, deeds of trust, and promissory notes, without any other changes, was not to be considered a satisfaction or disposition of an installment obligation under section 453(d) of the Code. Likewise Rev. Rul. 82-122, 1982-1 C.B. 80, holds that the substitution of a new obligor and a change in the rate of interest will not be considered a satisfaction or disposition of an installment obligation for purposes of section 453B(a).

Accordingly, under existing law, modification of an installment obligation by changing payment terms, such as increasing the rate of interest or deferring or increasing the payment dates will not constitute a disposition for purposes of the installment sales provisions. Moreover, where the original installment note is replaced, the substitution of a new promissory note without any other changes is not sufficient for the original note to be treated as "disposed of."

CONCLUSIONS

Based upon the facts and representations presented and the above analysis of applicable law, we conclude that the described modification of the terms of the Promissory Notes and the Stock Purchase Agreements (by reducing the Purchase Price and Interest Rate, and modifying the payment dates) is not a disposition or satisfaction of an installment obligation within the meaning of section 453B(a) of the Code.

This letter ruling is based on facts and representations furnished by the Taxpayer and its authorized representative, and is limited to the matters specifically addressed. Except as specifically ruled upon, we express or imply no opinion concerning the federal tax consequences of the transactions described in the facts under any other provision of the Code.

Because it could help resolve future federal tax issues, a copy of this letter should be maintained with the Taxpayer's permanent records, and attached to any federal income tax return to which it might be relevant.

Pursuant to a power of attorney on file with this office, copies of this letter ruling are being sent to the Taxpayer's authorized representative.

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

Sincerely,

/s/ William A. Jackson

William A. Jackson
Branch Chief, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures:

Copy of this letter

Copy for section 6110 purposes