

**Internal Revenue Service**

Department of the Treasury  
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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:ITA:B05  
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Date:  
May 19, 2016

A:  
B:  
Trust C:  
Partnership D:  
State E:  
F:  
G:  
H:  
Note:  
x%:  
y%:  
z%  
Year 1:

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

This ruling is in reference to a request for a private letter ruling dated December 21, 2015, submitted by your authorized representative. Specifically, you are requesting a ruling that under the facts described below, a waiver by Trust C and Partnership D of their *pro rata* share of a distribution by H of proceeds from the sale of Note will not result in dividend income to either Trust C or Partnership D.

**FACTS**

Trust C is revocable trust in State E. A and B are the beneficiaries and co-trustees of Trust C. Prior to Year 1, Trust C was the sole shareholder of G, a corporation. In Year 1, G entered into a merger agreement with F, a publicly traded corporation, whereby F was renamed H, remained publicly traded, and G became a wholly-owned subsidiary of H. As consideration for this merger, Trust C exchanged its stock in G for ownership of

approximately x% of the post-merger shares of H stock. The pre-merger shareholders of F owned the remaining approximately y% of the post-merger shares of H stock.

At the time of the merger, F owned Note, a subordinated debt instrument related to a prior business venture. As a result of the degree of uncertainty as to the amount of any payment the holder of Note might eventually receive, F and G were not able to agree on a price for Note while negotiating the merger. In order to proceed with the merger, F and G agreed that for purposes of determining merger consideration owed to Trust C, the fair value of Note would be zero. The parties further agreed that in the event that H disposed of Note within three years of the merger, the proceeds from such disposition would be distributed to all shareholders of H other than Trust C or related transferees of Trust C, and Trust C agreed, on behalf of itself and any related transferees, to waive any and all rights to its *pro rata* share of such a distribution. Pursuant to the merger agreement, any sale of Note and subsequent distribution of proceeds was to be solely controlled by a committee of Directors of H designated by F.

Later in Year 1, Trust C transferred a portion of its holdings in H equal to approximately z% of the post-merger shares of H stock to Partnership D, a limited liability company established for estate planning purposes and taxed as a partnership for federal income tax purposes. Partnership D is owned by trusts formed for the benefit of the children of A and B. Partnership D, as a related transferee of Trust C, acknowledged and agreed to the terms of the merger related to any distributions from the disposition of Note.

Finally, before the end of Year 1 but after the merger, H disposed of Note in a sale, and is currently planning to distribute the proceeds of such sale as a dividend to its shareholders, other than Trust C and Partnership D (the “nonwaiving shareholders”).

Trust C and Partnership D make the following representations:

- (1) There is a bona fide business reason for the proposed waiver of dividends because the waiver was an express condition of the merger between F and G. Therefore, the waiver will permit pre-merger shareholders of F to obtain the full value of their holdings and prevent Trust C and Partnership D from receiving windfall profits from property they do not own.
- (2) The relatives of the members and beneficiaries of Trust C and Partnership D are not in a position to receive in the aggregate more than 20 percent of the total dividends attributable to proceeds from the disposition of Note.
- (3) Trust C and Partnership D recognize that a ruling issued on the proposed waiver of dividends will not be effective if any change in the stock ownership enables nonwaiving relatives of the members and beneficiaries of Trust C and Partnership D to receive more than 20 percent of the total dividends attributable

to proceeds from the disposition of Note, unless the change occurs because of death.

- (4) Trust C and Partnership D acknowledge that a ruling issued on a proposed waiver of dividends transaction will not be effective for a period longer than three years from the date of the ruling.

## LAW AND ANALYSIS

Section 61(a)(7) of the Internal Revenue Code provides that except as otherwise provided in subtitle A, gross income means all income from whatever source derived, including dividends.

Generally, a majority shareholder who agrees to waive dividends while other shareholders receive theirs does not realize income if there is no family or direct business relationship between the majority and minority shareholders and the waiver is executed for valid business reasons. Rev. Rul. 45, 1953-1 C.B. 178. However, the waiver by a majority shareholder of the right to receive a pro rata share of any dividends paid by a corporation will not be recognized for income tax purposes where such dividends are paid to the relatives as minority shareholders as increased dividends, and the waiver results primarily in a benefit to the relatives. In general, if minority shareholder relatives benefit from a majority shareholder's dividend waiver, income is realized by the majority shareholder to the extent of the increased distribution to the related shareholders resulting from the waiver. See Rev. Rul. 56-431, 1956-2 C.B. 171.

Rev. Proc. 67-14 lists the conditions under which the Service will consider a request for a ruling on a proposed waiver of dividends transaction when the waiving and nonwaiving shareholders are individuals. The following four conditions must be satisfied: (1) a bona fide business reason must exist for the proposed waiver of dividends; (2) the relatives (e.g., brothers, sisters, spouse, ancestors, and lineal descendants) of the waiving shareholder must not be in a position to receive more than 20 percent of the total dividends distributed to the nonwaiving shareholders; (3) the ruling is not effective if any change in stock ownership (other than death) enables nonwaiving relatives to receive more than 20 percent of the dividend; and (4) a ruling issued on a proposed waiver of dividends transaction will not be effective for a period longer than three years from the date of the ruling.

Trust C is a revocable trust and Partnership D is a partnership. Because Trust C and Partnership D are not individuals, Rev. Proc. 67-14 is not determinative of whether a ruling request on a proposed dividend waiver will be considered. However, some of the conditions listed in Rev. Proc. 67-14 are appropriate for determining whether the Service will consider a request for a ruling on a proposed waiver of dividends transaction when the waiving shareholders are a revocable trust or a partnership.

One condition that is applicable is the existence of a bona fide business purpose. In this ruling request, it is represented that there is a bona fide business reason for the proposed waiver of dividends because the waiver was an express condition of the merger between F and G. Therefore, the waiver will permit pre-merger shareholders of F to obtain the full value of their holdings and prevent Trust C and Partnership D from receiving windfall profits from property they do not own.

As stated above, Trust C and Partnership D are a revocable trust and a partnership, respectively, and therefore, cannot have "relatives" as defined in Rev. Proc. 67-14. However, A and B, who are the beneficiaries and co-trustees of Trust C, and the children of A and B, who are the beneficiaries of the trusts that are the members of Partnership D, can have "relatives" within the meaning of Rev. Proc. 67-14. In this case, it is represented that relatives of the members and beneficiaries of Trust C and Partnership D are not in a position to receive in the aggregate more than 20 percent of the total dividends attributable to proceeds from the disposition of Note. Trust C and Partnership D also recognize that this ruling will no longer be applicable if any change in the stock ownership enables nonwaiving relatives of the members and beneficiaries of Trust C and Partnership D to receive more than 20 percent of total dividends attributable to proceeds from the disposition of Note, unless the change occurs because of death. Furthermore, Trust C and Partnership D understand that pursuant to Rev. Proc. 67-14, a ruling issued on a proposed waiver of dividends transaction will not be effective for a period longer than three years from the date of the ruling.

## CONCLUSION

Based on the information submitted, the applicable law, and the representations made, we conclude that a bona fide business reason does exist for the proposed dividends waiver and that nonwaiving shareholders who are relatives of the members and beneficiaries of Trust C and Partnership D are not in a position to receive in the aggregate more than 20 percent of the dividends distributed by H that result from H's sale of Note. Accordingly, the waiver by Trust C and Partnership D of the dividends resulting from the sale of Note will not result in gross income to either Trust C or Partnership D.

This ruling will no longer be applicable if any change in the stock ownership enables nonwaiving relatives of the members and beneficiaries of Trust C and Partnership D to receive more than 20 percent of the total dividends attributable to H's sale of Note, unless the change occurs because of death. In addition, this ruling will not be effective for a period longer than three years from the date of the ruling.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Enclosed is a copy of the letter ruling showing the deletions proposed to be made when it is disclosed under §6110.

In accordance with the Powers of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

William A. Jackson  
Branch Chief, Branch 5  
(Income Tax & Accounting)

cc: