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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:01
PLR-109136-24

Date:
November 8, 2024

Legend

X =

Y =

A =

State =

Year 1 =

Year 2 =

Date 1 =

Date 2 =

Plan =

Dear _____ :

This letter responds to a letter dated May 2, 2024, and subsequent correspondence, submitted on behalf of X by X's authorized representatives, requesting a ruling under § 1362(d)(2)(A) of the Internal Revenue Code (Code).

FACTS

According to the information submitted, X was organized under the laws of State on Date 1 and elected to be treated as an S corporation on Date 2. A owns, directly and indirectly, a majority of the stock in X.

In Year 1 X adopted an equity compensation plan, the Plan, which was subsequently amended, pursuant to which interests of X would be transferred by either A or X to employees or service providers of X and subsidiaries of X. The Plan also contemplates X and A assigning their repurchase rights to other employees and service providers such that those employees and service providers would be entitled to receive the stock of X repurchased from different employees and service providers. Prior to Year 1, X entered into other equity compensation arrangements, which subsequently incorporated the Plan by reference and are governed by its terms, pursuant to which interests of X would be transferred by either A or X to employees or service providers of X and subsidiaries of X (the Prior Plans). Other entities in which A had an interest have also entered into equity compensation arrangements, which have incorporated material provisions of the Plan by reference and are governed by its terms, pursuant to which interests of X would be transferred by either A or X to employees or service providers of such other entities in which A had an interest (the Additional Plans, together with the Plan and the Prior Plans, the Equity Compensation Plans).

X underwent a restructuring in Year 2. Before and after the restructuring, employees or service providers of X, its key subsidiaries, and a newly created parent company were covered by and participating in the Equity Compensation Plans. Due to the operation of the Equity Compensation Plans post restructuring, the transfers of interests of X by X or A to employees or service providers of X, subsidiaries of X or other entities in which A had an interest (collectively the Related Entities), continue to be made directly by either X or A. The operation of the Equity Compensation Plans and § 1.83-6(d) and § 1.1032-3(a)-(c) (or the principles of such sections), as described below, would, depending on the ownership of the Related Entities and their position in the organizational structure relative to either X or A in any particular transfer, cause the Related Entities to be deemed momentary owners of the interests of X in some transfers of interests in X to service providers by X, A, or their assignees contemplated by the Equity Compensation Plans. Most of these Related Entities are ineligible S corporation shareholders.

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 a “small business corporation” as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(d)(2) provides that an S corporation election will be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 83(h) and regulations § 1.83-6(a)(1) provide that, in the case of a transfer of property to which § 83 applies, the person for whom were performed the services in connection with which the property was transferred is allowed a deduction in an amount equal to the amount included under § 83(a), (b), or (d)(2) in the gross income of the person who performed the services.

Section 1.83-6(d)(1) provides that a transfer of property by a shareholder of an employer to a service provider or employee as payment for services is treated as a capital contribution by the shareholder to the corporation and then a transfer from the corporation to the service provider of such property. Section 1.83-6(d)(1) cross references § 1.1032-3 in discussing the treatment of a corporation transferring its own shares as compensation to someone who provides services to another corporation or partnership.

Section 1.1032-3(a) provides that the recharacterization of transactions under § 1.1032-3 applies to transactions in which a corporation or a partnership (the acquiring entity) acquires money or other property in exchange, in whole or in part, for stock of another corporation (the issuing corporation).

Section 1.1032-3(b) provides that if the rules of § 1.1032-3 apply, then the “transaction is treated as if, immediately before the acquiring entity disposes of the stock of the issuing corporation, the acquiring entity purchased the issuing corporation’s stock from the issuing corporation for fair market value with cash contributed to the acquiring entity by the issuing corporation (or, if necessary, through intermediate corporations or partnerships).” Section 1.1032-3(e) provides examples illustrating how these rules apply in the context of a compensatory arrangement in which stock is issued

to a service provider of a subsidiary entity of the issuing company (see Examples 4 and 5).

Section 1.1032-3(c) provides that the recharacterization of transactions under § 1.1032-3 applies to transactions only when the acquiring entity acquires issuing corporation stock in a transaction in which the acquiring entity's basis in the stock would otherwise be determined with respect to the issuing corporation's basis in the stock under § 362(a) or § 723; the acquiring entity immediately transfers the stock to acquire money or other property; the party receiving the stock from the acquiring entity does not receive a substituted basis; and the issuing corporation stock is not exchanged for stock of the issuing corporation.

While §§ 83 and 1032 and the regulations thereunder may not be directly applied to each transaction under the Equity Compensation Plans, the transactions described herein may be governed by their principles.

Section 83(h) and § 1.83-6(a)(1) function to match the timing of the service recipient's deduction for compensation paid to the timing of the income recognized by the service provider that receives the compensation. The deemed transaction created by § 1.83-6(d) directly links the parties receiving and providing services in exchange for the compensation and establishes the timing match for income and deduction related to compensation paid. Section 1.1032-3 extends the nonrecognition treatment of § 1032 to cover a subsidiary's use of parent stock to acquire property and pay compensation if certain specified conditions are satisfied. Section 1.1032-3 allows the purchase of property by a subsidiary using parent stock to be treated the same as the purchase of the property by the parent using its own stock followed by the parent transferring the property to its subsidiary. This treatment is achieved by characterizing the transaction, if certain specified conditions described in § 1.1032-3(c) are satisfied, as a deemed contribution of cash from a parent to its subsidiary and then the immediate deemed purchase of stock of the parent by the subsidiary with the deemed contributed cash. This approach is also adopted by section 1.1032-3 for compensatory payments by a subsidiary using its parent's stock and by cross-reference in § 1.83-6. The approach in these regulations gives the subsidiary a cost basis in the parent stock immediately before using it to purchase property or compensate a service provider so the subsidiary does not recognize gain on the transfer of the parent stock. The deemed transactions and resulting momentary ownership solely created by § 1.83-6 and § 1.1032-3 are transitory, created to solve timing and basis concerns arising from §§ 83 and 1032, and were not intended to impact S election status.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that transfers of interests of X by either A or X to employees and service providers of Related Entities under the Equity Compensation Plans cause momentary ownership of interests of X by ineligible S corporation shareholders pursuant to § 1.83-6(d) and

§ 1.1032-3(a)-(c) (or the principles of such sections) in some specific transactions contemplated by the Equity Compensation Plans depending on the ownership of the Related Entities and their position in the organizational structure relative to either X or A. Solely for purposes of § 1361, the momentary ownership by such ineligible shareholders resulting from the operation of § 1.83-6(d) and § 1.1032-3(a)-(c) (or the principles of such sections), which is insignificant and transitory, does not result in a termination of X's S election under § 1362(d)(2).

Except as specifically ruled on above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion concerning the application of §§ 83 and 1032 and the regulations thereunder, or the principles of such sections, to the Equity Compensation Plans beyond that they could apply in certain instances where X shares are transferred to service providers of ineligible shareholders to deem momentary ownership of interests of X by those ineligible shareholders. We also express or imply no other opinion as to the federal income tax consequences to X and A of the transfer of X shares pursuant to the Equity Compensation Plans.

The ruling contained in this letter is based on 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 requested ruling, it is subject to verification on examination.

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.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Robert Alinsky
Branch Chief Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

PLR-109136-24

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Enclosure

Copy for § 6110 purposes

cc: