

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200441023**

Release Date: 10/8/04

Index Number: 1361.01-04

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, ID No.

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Refer Reply To:

CC:PSI:B01 – PLR-163830-03

Date:

June 3 2004

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Dear :

This letter responds to a letter, dated November 3, 2003, written on behalf of Company requesting a ruling that Company's split-dollar life insurance arrangements will not cause more than one class of stock within the meaning of section 1361(b)(1)(D) of the Internal Revenue Code.

FACTS

According to the information submitted, Company is a calendar-year S corporation that uses the accrual method of accounting. Company was incorporated Date 1 and elected to be treated as an S corporation effective Date 2. Company has issued both voting and non-voting common stock, under state law each class has identical rights with respect to operating and liquidating distributions. Company proposes to enter into split-dollar life insurance agreements with trusts established for A, B, C, D, E, F, G, H, I, J, K, L, M, N, O, P, R, S and I (the Recipients).

Company intends to execute split-dollar insurance agreements with each of the Recipients or with the irrevocable trusts established by the Recipients. Recipients are obligated to pay Company a portion of the premium equal to the lowest annual cost of insuring the joint lives of the insureds on the applicable policy, determined in accordance with Notice 2002-8 and final Treasury Regulation §1.61-22 (T.D. 9092). Company is required to pay the total premium, if the Recipient fails to timely pay their portion of the premium to Company, the payment by Company to the insurance provider will be treated as a loan made by Company to Recipient. Upon the death of the survivor of the Recipients, Company has the right to receive a portion of the proceeds of the policy equal to any outstanding loans owed to Company by Recipient, plus the greater of the total amount of premiums paid by Company or the cash surrender value of the policy.

LAW AND ANALYSIS

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

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that meets the requirements specified in section 1361(b)(1)(A) through (D).

Section 1361(b)(1)(D) provides that S corporations may not have more than one class of stock. Section 1.1361-1(l)(1) of the Income Tax Regulations provides that,

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except as provided in section 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding agreement relating to distribution and liquidation proceeds and thus is not a governing provision unless a principal purpose of the arrangement is to circumvent the one class of stock requirement of section 1361(b)(1)(D) and section 1.1361-1(l).

Because the agreements in this case provide that, at the time Company pays the premiums, the Recipients, must reimburse Company to the extent the payments confer an economic benefit to the Recipients, Company's split-dollar life insurance agreements do not alter rights to distribution and liquidation proceeds.

CONCLUSION

Therefore, based solely on the facts submitted and the representations made, we conclude that Company's split-dollar life insurance agreements are fringe benefits, not a vehicle to circumvent the one class of stock requirement. Accordingly, Company's split-dollar life insurance arrangements do not create a second class of stock that would prevent Company from qualifying as a small business corporation under section 1361(b).

Except as specifically set forth above, no opinion is expressed or implied as to the federal income tax consequences of the transactions described above under any other provision of the code.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to the taxpayer and your second listed authorized representative.

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

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the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/s/ David R. Haglund

DAVID R. HAGLUND
Senior Technician Reviewer, Branch 1
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for section 6110 purposes

cc: