Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:
January 13, 2010

LEGEND

X =

D1 =

Dear :

This responds to a letter dated September 4, 2009, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1361(b)(1)(D) of the Internal Revenue Code.

Facts

According to the information submitted, X made an election to be treated as an S corporation effective D1. X subsequently discovered that due to some inadequate advice it received, some of the shareholders of X suffered financial damages. These shareholders sought compensation for the damages sustained. X seeks a ruling that such payments to compensate some of its shareholders for these damages will not constitute issuance of a second class of stock, which would jeopardize X's S corporation status under § 1361(b)(1)(D).

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.

Section 1361(b)(1) defines the term “small business corporation” as a domestic corporation that is not an ineligible corporation and that, among other things, does not have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that, except as provided in § 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 liquidation and distribution proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements (collectively, the governing provisions).

Conclusion

Based solely on the facts submitted and representation made, we conclude that the damages payments to some of X’s shareholders does not create a second class of stock. Therefore, X will be treated as continuing to be an S corporation, provided that X's S corporation election is not otherwise terminated under § 1362(d).

Except as expressly provided herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether X is an S corporation for federal tax purposes.

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.

Pursuant to the power of attorney on file with this office, a copy of this letter will be sent to X and X's other authorized representative.

Sincerely,

David R. Haglund
David R. Haglund
Chief, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):
Copy of this letter,
Copy for § 6110 purposes

cc: