

Internal Revenue Service

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Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

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Date:

January 26, 2012

Legend:

X =

State =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

Year =

Dear :

This responds to the letter dated December 21, 2011, and related correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code ("Code") for an inadvertent termination of S election.

FACTS

The information submitted states that X was incorporated under the laws of State on D1. X elected to be treated as an S corporation, effective D2. On D3, X, by amendment to its articles of incorporation, issued additional shares of stock, but did not file the amendment as required by State law. This amendment was later filed and became effective on D4.

On D5, X, by amendment to its articles of incorporation, issued additional shares of voting and nonvoting stock, but did not file the amendment as required by State law. This amendment was later filed and became effective on D6.

Beginning in Year, X made non-*pro rata* distributions to its shareholders. X determined that if these distributions are viewed as disproportionate distributions, X may have inadvertently created a second class of stock in violation of the one class of stock requirement under § 1361(b)(1)(D).

Immediately after the discovery of the errors, X took remedial action and made additional distributions to the shareholders so that all distributions are made *pro rata* to the shareholders.

X represents that its governing provisions provide for one class of stock, that all of its authorized, issued, and outstanding shares of stock confer identical rights to distribution and liquidation proceeds, and that it did not intend to create a second class of stock or terminate its S election. If X's S election was terminated, such termination was inadvertent and not motivated by tax avoidance or retroactive tax planning. In addition, X and its shareholders agree to make any adjustments required by the Commissioner consistent with the treatment of X as an S corporation.

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 the year.

Section 1361(b)(1)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation is generally 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.

Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock.

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 agreement is to circumvent the one class of stock requirement. Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall 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(f) provides, in part, that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consent, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely upon the facts submitted and representations made, we conclude that, because X made disproportionate distributions to its shareholders, X may have had more than one class of stock in Year. In addition, if any rights conferred by State law upon the issued but unauthorized stock of X differ in rights to distribution and liquidation proceeds from the issued and authorized stock, X may have had more than one class of stock upon issuance of the unauthorized stock. Accordingly, X's S election may have terminated.

We conclude, however, that if X's S election was terminated, such a termination was inadvertent within the meaning of § 1362(f). Further, we conclude that the corrective actions taken by X and its shareholders does not create a second class of stock under § 1361. Consequently, we rule that X will be treated as continuing to be an S corporation for Year, and thereafter, provided that X's S election is not otherwise terminated under § 1362(d).

Except as specifically ruled upon above, no opinion is expressed or implied concerning the tax consequences of any facts discussed or referenced in this letter.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling will be sent to your 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: