Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:

Telephone Number:

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Date:
June 24, 2013

LEGEND:

X =

A =

B =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

State =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

Dear

This responds to a letter dated December 19, 2012, submitted on behalf of X by its authorized representative, requesting a ruling under the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State on D1, and elected to be an S corporation effective D2.

At the time of the S election, all of the shares of X stock were held equally by A and B, husband and wife, until A died on D3. On D4, following the administration of A's estate, A's estate distributed its shares of X to Trust 1, Trust 2, and Trust 3. Additionally on D4, B contributed B's shares to Trust 4, a grantor trust.

X represents that Trust 1, Trust 2, and Trust 3 were qualified subchapter S trusts (QSSTs) eligible to make an election under § 1361(d)(2) effective D5. During the two years between D4 and D5, Trust 1, Trust 2, and Trust 3 were eligible shareholders by reason of § 1361(c)(2)(A)(iii). However, no QSST elections were filed on behalf of Trust 1, Trust 2, or Trust 3. Therefore, Trust 1, Trust 2, and Trust 3 were not permissible shareholders, and X's S corporation election terminated on D5.

Beginning D4, X made disproportionate distributions among its shareholders, Trust 1, Trust 2, Trust 3, and Trust 4. X represents that the failure to make pro rata distributions to its shareholders was inadvertent. After X learned of this failure, X made corrective distributions to Trust 1, Trust 2, and Trust 3 on or before D6, thus eliminating the cumulative amount of the disproportionate distributions.

X represents that the termination was not motivated by tax avoidance or retroactive tax planning. X further represents that from D5, X and its shareholders have filed all returns consistent with X's status as an S corporation. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(b)(1) provides for purposes of subchapter S, the term "small business corporation" means 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(f) provides, in relevant 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 consents, 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 event 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 shareholders consents; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), 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, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides, in part, that a corporation that has more than one class of stock does not qualify as a small business corporation. 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. 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, in part, 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). 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.

Based solely on the facts submitted and representations made, we conclude that because X's stock has identical distribution and liquidation rights under its governing provisions, the difference in timing between X's disproportionate distributions to some of the shareholders and X's corrective distributions to certain shareholders do not cause X to have more than one class of stock for purposes of § 1361(b)(1)(D). However, such disproportionate and corrective distributions must be given appropriate tax effect.

Under these circumstances, we conclude that X's S corporation election did not terminate because of the disproportionate and corrective distributions to the shareholders.

Additionally, based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on D5 because Trust 1, Trust 2, and Trust 3 were not eligible shareholders of X. We further conclude that the termination of X's S corporation election on D5 was inadvertent within the meaning of § 1362(f). Therefore, X, will be treated as an S corporation effective D5 and thereafter, provided X's S corporation election is not otherwise terminated under § 1362(d).

This ruling is conditioned upon B filing QSST elections for Trust 1, Trust 2, and Trust 3, respectively, with an effective date of D5 within 120 days of the date of this ruling. A copy of this letter should be attached to each election.

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. Specifically, no opinion is expressed regarding X's eligibility to be an S corporation or the validity of its S corporation election. No opinion is expressed as to whether Trust 1, Trust 2, or Trust 3 qualifies as a QSST or whether any other shareholder of X is a permissible S corporation shareholder.

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.

This ruling is directed 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 the Power of Attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
(Passthroughs & Special Industries)

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