Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-126808-14

Date:
December 29, 2014

LEGEND:

X =

State =

Date 1 =

Date 2 =

Year 1 =

Year 2 =

A =

B =

C =

D =

E =

Dear

This responds to a letter dated June 25, 2014, submitted on behalf of X by its authorized representatives, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

Facts

The information submitted states that X was incorporated on Date 1 in State and elected to be treated as an S corporation effective Date 2. From Year 1 to Year 2, X made disproportionate distributions to its shareholders, A, B, C, D and E. X's Articles of Incorporation provide that there shall only be one class of X stock, each share of which shall have equal powers, preferences, and rights. In Year 2, X made corrective distributions to A, C, D, and E in an effort to eliminate the cumulative amount of the disproportionate distributions.

X represents that neither X nor its shareholders intended to terminate X's Subchapter S election. In addition, X represents that X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) that may be required by the Secretary.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to the 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 the term "small business corporation " means a domestic corporation that, among other things, does not have more than one class of stock. Accordingly, S corporations may not have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides 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 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(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) further provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and the representations made, we conclude that if the disproportionate distributions that X made to its shareholders in Year 1 through Year 2 caused X's S corporation election to terminate, the termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation effective Date 2 and thereafter, provided X's S corporation election is not otherwise terminated under § 1362(d). However, disproportionate and corrective distributions must be given appropriate tax effect.

Except as specifically set forth above, we express or imply no opinion as to the federal tax consequences of the above facts under any other provision of the Code. Specifically, we express or imply no opinion concerning whether X's S corporation election is valid under § 1362.

This ruling is directed only to the taxpayer who requested 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 sent to X's authorized representative.

Sincerely,

Joy C. Spies
Joy C. Spies
Senior Technician Reviewer, Branch 1
(Passthroughs & Special Industries)

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

cc: