Internal Revenue Service

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Department of the Treasury
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
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Date:
July 28, 2015

Legend

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

$N1 =

Class A =

Class B =

Dear :

This letter responds to a letter dated January 29, 2015, and subsequent correspondence, written on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was formed as a State limited liability company prior to Date 1, and made an election to be treated as an S corporation effective Date 1.

X's operating agreement was amended and restated as of Date 2, to authorize the issuance of new classes of membership interests in X. The shares held by the original members were classified as Class A units. The amended operating agreement provided that a holder of the Class A units would each receive a $N1 preferential distribution right over the Class B unit holders, and would hold the sole voting rights. Class B unit holders would share in the distributions after the preferential distributions on a pro rata basis with the Class A unit holders.

At the time that the operating agreement was amended, the original members exchanged their ownership interests for Class A units. Beginning on Date 3 through Date 4, X issued interests in the Class B units to various persons.

In Date 5, X amended its operating agreement to eliminate the Class A preferred distribution rights and to provide that the Class B unit holders have distribution rights that are identical to the distribution rights that the Class A unit holders have. On Date 6, X made corrective distributions to eliminate the effect of the Class A preferred distribution rights.

X represents that it was not aware that issuing new classes of stock with differing distribution rights to shareholders could terminate X's S corporation election. X represents that any termination of its S corporation election was not motivated by tax avoidance or retroactive tax planning. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation, as might be required by the Secretary.

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 such year.

Section 1361(b)(1) provides that 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 1.1361-1(l)(1) 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). 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) will be terminated whenever (at any time on or after the 1st day of the 1st 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 was terminated under § 1362(d)(2); (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 such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in 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 termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election terminated on Date 3 as a result of X issuing units in more than one class of stock. We further conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f).

Therefore, we determine that pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided that X's S corporation election was otherwise valid and has not otherwise been terminated under §1362(d). Accordingly, from Date 3 and thereafter, the shareholders of X, including any Class B unit holders that were shareholders during the relevant year, must include their pro rata share of the separately stated and non-separately stated computed items of X as provided in §1366, make any adjustments to basis as provided in §1367, and take into account any distributions made by X as provided in §1368. If X and its shareholders fail to treat X as described above, this ruling will be null and void.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation.

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.

In accordance with a power of attorney on file with this office, we will send a copy of this letter ruling to X's authorized representative.

Sincerely,

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

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