Internal Revenue Service

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Washington, DC 20224

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Person To Contact:
, ID No.
Telephone Number:

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October 05, 2015

Legend

X =

A =

B =

C =

D =

E =

$A =

$B =

$C =

$D =

$E =

Date 1 =

Date 2 =

Year A =

Year B =

State =

Dear :

This responds to a letter dated March 31, 2015 and subsequent correspondence, submitted on X's behalf by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation effective Date 2. A, B, and C were shareholders and officers of X in Year A. B is the sole owner of D. C is a shareholder of E.

During Year A, X transferred $A, $B, $C, $D, and $E to A, B, C, D and E, respectively. X's advisor determined that those amounts may be disproportionate distributions to A, B, and C in violation of the one class of stock requirement under section 1361(b)(1)(D). To correct the possible terminating event, X will make corrective distributions to the shareholders in Year B. X and its shareholders will make consistent adjustments to their returns for Year A for the treatment of $A, $B, $C, $D and $E.

X represents that under X's governing provisions, all of X's shares of stock have possessed identical rights to distributions and liquidation proceeds from Date 2. X represents that the form of the transfers of $A, $B, $C, $D, and $E did not have as a principal purpose, the circumvention of the one class of stock requirement applicable to S corporations. X represents that the circumstances resulting in the possible termination were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X further represents that X and its shareholders consistently treated X as an S corporation since the time of its election. Lastly, X and its shareholders have agreed to make such adjustments, consistent with the treatment of X as an S corporation, as may be required by the Service.

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) defines a “small business corporation” as 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) 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.

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 of § 1361(b)(1)(D) and § 1.1361-1(l). 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 first day of the first taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

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 the ineffectiveness or termination were inadvertent; (3) no later than a reasonable

period of time after discovery of the circumstances resulting in such 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 § 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 with respect to this period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

We conclude that if X's S corporation election terminated, any such termination was inadvertent within the meaning of § 1362(f). Consequently, X will continue to be treated as an S corporation from Date 2, and thereafter, provided X's S election is not otherwise terminated under § 1362(d).

Accordingly, X's shareholders, in determining their respective income tax liabilities, must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account distributions made by X as provided by § 1368. As an additional condition to this letter, X and its shareholders must take the steps as indicated above to correct the possible terminating event.

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 or implied on whether X was or is otherwise eligible to be treated as an S corporation or the correct treatment, for Federal tax purposes, of X's transfers of $A, $B, $C, $D and $E.

The ruling contained in this letter is 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 only to the taxpayer requesting 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 is being sent to your authorized representative.

Sincerely,

Laura C. Fields
Laura C. Fields
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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