**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:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:01
PLR-119112-15

Date:
December 04, 2015

Legend

X =

Y =
State =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
P1 =
P2 =

Dear :

This responds to a letter dated June 3, 2015, and subsequent correspondence, submitted on behalf of X by its authorized representatives, requesting a ruling relating to X's status as an S corporation under §§ 1361 and 1362 of the Internal Revenue Code.

## FACTS

The information submitted states that X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation for Federal tax purposes effective Date 1. On Date 2, shares of X were transferred to Y, a corporation, in satisfaction of a loan obligation. The transfer of X stock to Y, an ineligible S corporation shareholder within the meaning of § 1361(b)(1)(B), caused X's S corporation election to terminate on Date 2.

The information submitted states that X filed an Amended and Restated Certificate of Incorporation on Date 3, which created a new series of X stock that had a preference as to dividends and liquidation proceeds. As of Date 3, X had issued and outstanding two classes of stock within the meaning of § 1361(b)(1)(D) and that would have terminated X's S corporation election had it not already been terminated.

On Date 4, in accordance with the terms of a stock purchase agreement, X transferred shares of X preferred stock to P1 and P2. P1 and P2 are partnerships for Federal income tax purposes and, thus, are not eligible S corporation shareholders within the meaning of § 1361(b)(1)(B). The transfer of stock to P1 and P2 on Date 4 would have caused X's S corporation election to terminate had it not already been terminated.

X represents that all circumstances resulting in the termination of X's S corporation election were inadvertent and not motivated by tax avoidance. X further represents that X filed returns consistent with X's status as an S corporation through tax period ending Date 5. X and its shareholders agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

## LAW

Section 1361(a) 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) 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 § 1362(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 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, by-laws, 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 1.1361-1(l)(3) provides that, except as provided in §§ 1.1361-1(b)(3), (4), and (5) (relating to restricted stock, deferred compensation plans, and straight debt), in determining whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds, all outstanding shares of stock of a corporation are taken into account.

Section 1362(a) provides, in part, that 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 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 (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 § 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, 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 on the facts submitted and representations made, we conclude X's S election was terminated and such termination was inadvertent within the meaning of § 1362(f). Consequently, we rule that X will be treated as an S corporation from Date 2, and thereafter, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d). X shall file or amend returns for tax periods beginning on or after Date 2 consistent with this ruling.

This ruling is contingent upon X filing amended and restated certificate of incorporation consistent the provisions of § 1361(b)(1)(D) and the transfer of stock held by Y, P1, and P2 to eligible shareholders by Date 6.

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. 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. Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

*David R. Haglund*
David R. Haglund
Branch Chief, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)
Copy of Letter
Copy for 6110 purposes

cc: