Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

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Date:
September 18, 2017

Legend

X =

State =

D1 =

D2 =

D3 =

D4 =

Y1 =

r =

Dear :

This responds to a letter dated March 17, 2017, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that X was incorporated under the laws of State on D1 and elected to be an S corporation effective D2. Effective D3, X's Board of Directors adopted a resolution extending the eligibility to participate in X's medical and

dental plans to X's non-employee shareholders, including beneficiaries of trusts owning X stock, and any spouse or unmarried dependent children of any shareholder or beneficiary. Thereafter, a non-employee beneficiary of trusts owning X stock and members of her family participated in X's medical plan. The beneficiary and her family timely paid to X the employee share of the premiums determined on the same basis as X's employees in the medical plan, but did not reimburse X for the employer share of the premiums.

X later consulted with tax advisors about the board resolution, who advised against this arrangement. X's Board of Directors resolved to no longer allow non-employee shareholders to participate in its medical and dental plans, removing them as of D4. In addition, in Y1, the beneficiary and her family members paid X the difference between the employee share of the premiums and the COBRA amount charged to former employees for medical coverage, which totaled $r.

X represents that the board resolution was a binding agreement under State law which permitted deemed disproportionate distributions to shareholders and caused X to have a second class of stock. X represents that the resulting termination of its S corporation election was inadvertent, and not motivated by tax avoidance or retroactive tax planning. 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.

X requests a ruling that the termination of X's S corporation election was inadvertent within the meaning of section 1362(f) and that it will be treated as an S corporation from D3 and thereafter.

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) 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).

In §1.1361-1(l)(2)(vi), Example 6 (agreement to adjust distributions for state tax burdens), S, a corporation, executes a binding agreement with its shareholders to modify its normal distribution policy by making upward adjustments of its distribution to those shareholders who bear heavier state tax burdens. The adjustments are based on a formula that will give the shareholders equal after-tax distributions. The example states that the binding agreement relates to distribution or liquidation proceeds. The agreement is thus a governing provision that alters the rights conferred by the outstanding stock of S to distribution proceeds so that those rights are not identical. The example concludes that under § 1.1361-1(l)(2)(i), S is treated as having more than one class of stock.

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 D3 as a result of X having more than one class of stock. We further conclude that X's S corporation election was inadvertent within the meaning of § 1362(f).

X has taken corrective action so that it once again meets the requirements of a small business corporation under § 1361(b). Therefore, we determine that pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D3 and thereafter, provided that X's S corporation election was valid and, apart from the inadvertent termination ruling described above, has not otherwise terminated under § 1362(d).

Except as specifically set forth above, we express or imply no opinion as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether X is otherwise eligible to be an S corporation.

These rulings are directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

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 rulings requested, it is subject to verification on examination.

Sincerely,

Holly A. Porter
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

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