

**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:03  
PLR-121000-17  
Date:  
December 21, 2017

Legend:

X =

Shareholders =

! =

J =

Agreement 1 =

Agreement 2 =

New Agreement 1 =

New Agreement 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to a letter dated June 30, 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 Date 1 and elected to be an S corporation effective Date 2.

On Date 3, X and I entered into Agreement 1 granting equity in X to I. On Date 4, X and J entered into Agreement 2 granting equity in X to J. Although I and J received equity in X, I and J were not entitled to the same rights to distribution and liquidation proceeds as X's Shareholders because under their respective agreements I and J would only receive

proceeds upon a sale of X's assets. X represents that the equity granted to I and J created a second class of stock, and, as a result, X's S corporation election terminated on Date 3. Once X learned that it had a second class of stock, X, I, and J cancelled their respective agreements and entered into New Agreement 1 and New Agreement 2, respectively (collectively, the New Agreements) on Date 5.

X represents that it (1) intended to be an S corporation effective Date 2 and continuously thereafter; and (2) filed all returns consistent with being an S corporation since Date 2. In addition, X and Shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Commissioner with respect to the period specified by §1362(f).

### 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 the 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 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) 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, 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 the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the 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 the ineffectiveness or

termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides, in part, 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.

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, governing provisions).

### CONCLUSION

Based on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date 3 because X had more than one class of stock as a result of its Agreement 1 with I. Also, had X's S corporation election not terminated on Date 3, we conclude that it would have terminated on Date 4 because X had a second class of stock as a result of its Agreement 2 with J. We further conclude that any such termination resulting from Agreements 1 and 2 was inadvertent within the meaning of §1362(f). Thus, X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided X's S corporation election was otherwise valid and has not otherwise terminated under §1362(d).

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. In particular, we express or imply no opinion regarding whether the New Agreements create a second class of stock.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

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 ruling request, it is subject to verification on examination.

Pursuant to a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

*Mary Beth Carchia*

Mary Beth Carchia  
Senior Technician Reviewer, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

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

cc: