Internal Revenue Service

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Department of the Treasury
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Third Party Communication: None
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Person To Contact:
, ID No.

Telephone Number:

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Date:
July 05, 2018

LEGEND

X =

State1 =

State2 =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Year =

Dear :

This responds to a letter dated December 15, 2017, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under §1362(f) of the Internal Revenue Code ("Code").

FACTS

The information submitted states that X was formed under the laws of State1 on Date1 as a limited liability company, and elected to be classified as an association taxable as a corporation and also elected to be an S corporation effective on Date2. At the time of formation, the members of X adopted an operating agreement that included a provision providing for an order of priority for distributing the assets of X upon liquidation ("Liquidation Provision"). According to the submission, the Liquidation Provision provided for the distribution of liquidation proceeds in accordance with capital accounts, whereby distributions made by X potentially would not be made to the shareholders of X in accordance with their respective ownership percentages. As a result, the outstanding shares of stock of X did not possess identical rights to distribution and liquidation proceeds. Accordingly, X represents that X did not meet the requirement that it have one class of stock under section 1361(b)(1)(D) on the effective date of its S election on Date2.

The submission further indicates that X was initially formed with the intention that X would be treated as a partnership for federal tax purposes and, therefore, the Liquidation Provision did not present any tax issues at that time. On Date3, the shareholders of X adopted an amended operating agreement whereby X admitted new shareholders and changed from a member-managed limited liability company to a manager-managed limited liability company. The amended operating agreement also contained the Liquidation Provision. On Date4, the shareholders of X adopted a second amended operating agreement whereby X admitted new shareholders, among other things. Although the distribution of proceeds upon the liquidation of X was slightly modified in the second amended operating agreement, the agreement still contained the Liquidation Provision. On Date5, X filed Articles of Conversion whereby X converted from a State1 limited liability company to a State2 limited liability company. The Plan of Conversion provided that all ownership interests in X would remain the same as those prior to the conversion.

When X's owners became aware of the second class of stock issue in Year, they sought tax counsel to assist with amending X's operating agreement to modify the Liquidation Provision to provide that, upon liquidation of X, distributions be made in accordance with the ownership percentages in X, not capital accounts.

X represents that X and X's shareholders have filed tax returns consistent with X being an S corporation since Date2. X further represents that the circumstances resulting in the ineffectiveness of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and each person who was or is a shareholder of X at any time since Date2 agree to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period. X further represents X has taken all of the

necessary corrective steps to rectify the ineffectiveness of X's S corporation election. Specifically, X represents that X has amended its operating agreement to remove all provisions that could create a second class of stock.

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 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 laws, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions).

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2) 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. A termination of an S corporation election under § 1362(d)(2) is effective on or after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) 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) or § 1361(b)(3)(C), (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 for which the election was made or the termination occurred is a small business corporationor a qualified subchapter S subsidiary, as the case may be, or (B) to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) 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 or a qualified subchapter S subsidiary, as the case may be during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election was ineffective on Date2 as a result of the second class of stock due to the Liquidation Provision contained in X's operating agreement. We conclude that this ineffectiveness was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as an S corporation beginning on Date2 and continuing thereafter, unless X's S corporation election otherwise terminated under §1362(d) for other reasons.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation.

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 a ruling, it is subject to verification on examination.

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 the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

Caroline E. Hay
Assistant to the Branch Chief
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

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