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:
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Date:
September 09, 2019

Legend

X =

Y =

A =

B =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Operating Agreement =

Dear :

This letter responds to a letter dated April 17, 2019, 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 organized as a limited liability company under the laws of State on Date 1. A and B were the members of X on Date 1. X elected to be an S corporation effective Date 2. On Date 3, X's Operating Agreement included provisions regarding partnerships. Section 4(j) of the Operating Agreement provides, in part, that it is intended that X will be treated as a partnership for federal income tax purposes and that each Member will be treated as a partner of a partnership for tax purposes. Section 4(a) provides, in part, that X shall have two (2) classes of Units: Class A Units and Profits Units. Sections, 4, 8, and 19 of the Operating Agreement state that a Profits Interest only shares in liquidation proceeds due to profits earned after the issuance of the Profit Unit. On Date 4 and Date 5, X issued Profits Interests.

When X's shareholders discovered the effect of the partnership provisions and the issuance of the Profits Interests, X canceled the Profits Interests between Date 6 and Date 7. X amended its operating agreement on Date 8 to remove the partnership provisions and the Profits Interest provisions and to provide identical distribution and liquidation rights to X's shareholders. On Date 9, X merged into Y, with Y surviving the merger, in a transaction intending to qualify as a reorganization described in § 368(a)(1)(F), in accordance with Income Tax Regulation §§ 1.368-2(m)(3)(i) and 1.368-2(m)(4).

X represents that the termination of X's S corporation election was inadvertent and not the result of retroactive tax planning. X further represents that no federal tax return of any person has been filed inconsistent with a valid S corporation election having been made for X effective Date 2. X also represents that all distributions and allocations of income to its shareholders have been made pro rata in accordance with their interests in X. X and X's shareholders have agreed to make any adjustments required by the Service consistent with the treatment of X as an S corporation.

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 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(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)(A) provides that an election under § 1362(a) is 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) provides that any termination under § 1362(d)(2)(A) is effective on and 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 (i) 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 (ii) 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 such ineffectiveness or termination, steps were taken so that the corporation for which the election was made or the termination occurred is a small business corporation or a QSub, as the case may be, or 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 of the corporation at any time during the period specified pursuant to § 1362(f), agree to make the adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation or a QSub, as the case may be, 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 laws, and binding agreements relating to distribution and liquidation proceeds (collectively, governing provisions).

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election terminated on Date 3 because X had more than one class of stock due to the provisions in the Operating Agreement. We also conclude that the termination of X's S corporation was inadvertent within the meaning of § 1362(f). Accordingly, under the provisions of § 1362(f), X will be treated as an S corporation from Date 3 until Date 9, provided that X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d).

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was otherwise a valid S corporation. We also express no opinion on whether X's merger into Y qualifies as a § 368(a)(1)(F) reorganization.

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

Pursuant to a power of attorney on file, we are sending a copy of this letter 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,

Richard T. Probst
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: