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:

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Date:
July 06, 2020

LEGEND

Company =

State =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Wife =
Husband =
Agreement 1 =

Agreement 2 =

Dear :

This letter responds to a letter dated December 9, 2019, and subsequent correspondence submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states Company was organized on Date 1 as a limited liability company under the laws of State. At the time, Company had one owner, Wife, and was treated as a disregarded entity for Federal income tax purposes. Although Company had only one owner, Company's initial operating agreement, Agreement 1, included provisions in contemplation of Company being treated as a partnership for

Federal income tax purposes; however, the applicability of those provisions was not limited to such a situation. Agreement 1 contained the following partnership provisions:

(1) Section 4.1, Cash Flow and Distributions, providing in part that “[a]ll distributions shall be made to the Members in proportion to their respective Percentage Interests”; and

(2) Section 4.2, Allocation of Income, providing in part that “to each Member in proportion to their respective Partnership Interests”; and

(3) Section 4.2, Allocation of Losses, providing in part “to the Members in proportion to their respective Partnership Interests”; and

(2) Section 4.9, Adjustment of Capital Accounts, providing in part that the “tax allocation provisions of this Agreement are intended to produce final Capital Accounts balances that are at levels (“Target Final Balances”) which permit liquidating distributions that are made in accordance with such final Capital Account balances to be equal to the distributions that would occur under Section 4.1 hereof if such liquidating proceeds were distributed pursuant to such Section 4.1”; and

(3) Section 4.9 further providing in part that "[t]o the extent that the tax allocation provisions of this Agreement would not produce the Target Final Balances, the Members agree to take such actions as are necessary amend such tax allocation provisions to produce such Target Final Balances"; and

(4) Section 9.4, Winding Up and Termination, providing in part that upon the dissolution of the Company, the balance of the Company's assets "shall be liquidated and disposed of and distributed...in proportion to the positive balances in the Members' Capital Accounts."

Agreement 1 was subsequently amended on Date 2 and Date 3 for changes to the Company's place of business, change in the name and address of the registered agent, a change in the Company's managers, and the admission of Husband on Date 3. Wife and Husband continued to treat Company as a disregarded entity for federal tax purposes.

On Date 4, the two owners of Company filed Form 8832, Entity Classification Election, on behalf of the Company to change the Company's entity classification to a domestic eligible entity classified as an association taxable as a corporation effective Date 5. On Date 4, the two owners also field form 2553, Election by a Small Business Corporation to elected S corporation treatment for Company effective Date 5.

Company states that on Date 6, Agreement 1, as amended, was further amended and was replaced by Agreement 2 in order to eliminate the potential for a second class of stock under § 1361(b)(1)(D).

Company represents that Company and its shareholders have filed tax returns consistent with Company having a valid S corporation election in effect as of Date 5. In accordance with §§ 1362(f) and 1.1362-4, Company and each person who has been a shareholder of Company at any time on or after Date 5 through the date of the ruling request have consented to any adjustments as may be required by the Secretary. Company requests relief pursuant to § 1362(f) due to its governing provisions creating more than one 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) provides that for purposes of subchapter S, the term "small business corporation" means a domestic corporation, which is not an ineligible corporation and does not have (A) 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 subsection § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1.1361-1(l)(1) 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).

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) 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 (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 (ii) 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 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; 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 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 during the period specified by the Secretary.

CONCLUSION

Based on the facts submitted and representations made, we conclude that the S election was ineffective. Company had more than one class of stock due to the partnership provisions in Agreement 1. We conclude that the ineffectiveness of Company's S election as a result of the provisions in Agreement 1 creating a second class of stock was inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), Company will be treated as an S corporation from Date 5, and thereafter, provided the S election for Company is otherwise valid and has not terminated under § 1362(d).

Except as specifically ruled above, we express or imply no opinion as to the federal income tax consequences of the facts described above under any other provision of the Code, including Company's eligibility to be a valid S corporation.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it 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.

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: