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April 11, 2012

LEGEND

X =

State =

Date =

1
Date =

2
Date =

3

Dear _____ :

This responds to a letter dated December 29, 2011, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1361(b)(1)(D) of the Internal Revenue Code.

FACTS

The information submitted states that X was incorporated under the laws of State and filed an S corporation election effective for its taxable year beginning Date 1. From Date 1 through Date 2, X made disproportionate allocations of income and disproportionate distributions to its shareholders. X represents that under State law, all of X's stock have identical rights to distribution and liquidation proceeds. No provision in X's articles of incorporation, bylaws, or any other governing instruments altered those rights. X further represents that there is no agreement, written or oral, that any

shareholder would be entitled to a preference regarding X's distribution or liquidation proceeds.

X represents that starting Date 3, it will make the represented adjustments to rectify the disproportionate allocations of income and distributions made from Date 1 to Date 2.

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)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not, among other things, 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 stock 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). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

In § 1.1361-1(l)(2)(vi), Ex. 2 (Distributions that differ in timing), S, a corporation, has two equal shareholders, A and B. Under S's bylaws, A and B are entitled to equal distributions. S distributes \$50,000 to A in the current year, but does not distribute \$50,000 to B until one year later. The circumstances indicate that the difference in timing did not occur by a binding agreement relating to distribution or liquidation proceeds. The example concludes that under § 1.1361-1(l)(2)(i), the difference in timing of the distributions to A and B does not cause S to be treated as having more than one

class of stock. However, § 7872 or other recharacterization principles may apply to determine the appropriate tax consequences.

CONCLUSION

Based solely on facts submitted and representations made, we conclude that because X has identical distribution and liquidation rights under its governing provisions, the difference in timing between X's disproportionate distributions and the corrective distributions to its shareholders does not cause X to be treated as having more than one class of stock for purposes of § 1361(b)(1)(D). However, X's disproportionate and corrective distributions to its shareholders must be given appropriate tax effect. Under these circumstances, we conclude that X's S corporation election did not terminate because of the disproportionate and corrective distributions.

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

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

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

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):

A copy of this letter
A copy for § 6110 purposes

cc: