

Internal Revenue Service

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X =

A =

B =

State =

a =

b =

Year =

D1 =

D2 =

D3 =

D4 =

Dear :

This responds to a letter dated September 4, 2009 and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling relating to X's status as an S corporation under §§ 1361 and 1362 of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State and made an election to be treated as an S corporation effective D1. A and B were the only shareholders of X until they sold their all of their stock on D3 to an unrelated corporation. From Year to D3, A owned a and B owned b of the stock of X, and X made disproportionate distributions to A and B during the course of operations.

X represents that each share in X has identical rights to liquidation proceeds and distributions. No provision exists in the governing documents, regulations, or by-laws

that vary these rights. X also represents that no other binding agreements exist that vary these rights. In addition, X represents that a corrective distribution and a payment by A to B were completed on D2 and D4, respectively. X further represents that the corrective distribution and payment by A to B resulted in distributions proportionate to A and B's respective interests in X since its inception as an S corporation. Finally, X represents that it has intended to be an S corporation since its election effective D1.

A and B each represent that they have not received a distribution that was not a nontaxable return of capital, to the extent of X's accumulated adjustment account or in excess of their stock basis. Additionally, X represents that at all relevant times, X and its shareholders treated X as an S corporation and filed their tax returns accordingly. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Law and Analysis

Section 1361(a) 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 the term "small business corporation" means 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 1 class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides 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 rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock. Thus, if all shares of stock of an S corporation have identical rights to distribution and liquidation proceeds, the corporation may have voting and nonvoting common stock, a class of stock that may vote only on certain issues, irrevocable proxy agreements, or groups of shares that differ with respect to rights to elect members of the board of directors.

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,

the governing provisions). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding agreement relating to distribution and liquidation proceeds and thus is not a governing provision unless a principal purpose of the agreement is to circumvent the one class of stock requirement of § 1361(b)(1)(D) and § 1.1361-1(l). 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.

Section 1.1361-1(l)(3) provides that, except as provided in §§ 1.1361-1(b)(3), (4), and (5) (relating to restricted stock, deferred compensation plans, and straight debt), in determining whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds, all outstanding shares of stock of a corporation are taken into account.

Section 1362(a) provides, in part, that a small business corporation may elect 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.

Conclusion

Based solely on the facts submitted and representations made, we conclude that the disproportionate distributions X made to A and B did not create a second class of stock for purposes of § 1361(b)(1)(D). Thus, we conclude that X's S corporation election did not terminate under § 1362(d)(2)(A) and that X will be treated as an S corporation beginning on D1 and thereafter, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d). This ruling is contingent upon X and A having made corrective distributions and payments so that each shareholder has received distributions proportionate to their interests in X from D1 and thereafter. Failure to make such corrective distributions and payments will render this ruling void.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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