

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B02  
PLR-104568-10

Date:  
June 28, 2010

X =

State =

D1 =

D2 =

D3 =

D4 =

Dear :

This responds to a letter dated January 27, 2010, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states X was incorporated under the laws of State on D1. On D2, X filed a certificate of correction to divide the common stock of X into Class A and Class B shares. The certificate of correction permitted X to declare a special dividend payable only with respect to the Class B shares. X elected subchapter S status, effective D3. On D4, X filed a restated certificate of incorporation eliminating the right to declare a special dividend with respect to the Class B shares. X represents it never declared any special dividend payable with respect to the Class B shares.

X determined that due to the issuance of Class A and B stock to its shareholders, X inadvertently created a second class of stock in violation of the one class of stock requirement in § 1361(b)(1)(D).

X represents that it did not intend to create a second class of stock. X and its shareholders represent that all allocations of income, losses, deductions and credits for X were made on a pro rata basis among all the shareholders of both classes of stock as

though all shares were one class of stock for all years at issue. Furthermore, X represents that the issuance of more than one class of stock was not motivated by tax avoidance.

X represents that it and its shareholders timely and consistently filed their tax returns consistent with the treatment of X as an S corporation. 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)(1) of the Code 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)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not 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.

Section 1361(b)(1)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides 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 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. 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 1362(d)(2) provides that (A) in general, 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 and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) 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), (2) the Secretary determines that the circumstances resulting in the 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 is a small business corporation or (B) to acquire the shareholder consents; and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Based on the information submitted and the representations made, we conclude that X's S corporation election was ineffective because X had more than one class of stock. However, we conclude that, such ineffectiveness was inadvertent within the meaning of § 1362(f) of the Code. Consequently, we rule that X will be treated as an S corporation from D3, and thereafter, provided that X's S election otherwise is not terminated under § 1362(d).

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. In particular, we express no opinion as to whether X otherwise qualifies as a subchapter S corporations under § 1361.

This ruling is directed only to the taxpayer that requested 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  
Acting Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

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