

Internal Revenue Service

Department of the Treasury
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September 20, 2010

LEGEND

Company =

Remedial Distributions =

State =

a =

b =

Dear :

We received a letter dated April 6, 2010, and subsequent correspondence, submitted on behalf of Company by its authorized representative requesting a ruling under § 1362(f) of the Internal Revenue Code (Code). This letter responds to that request.

FACTS

Company was incorporated under the laws of State and filed an S corporation election effective for its taxable year beginning a. Following its S corporation election, Company made disproportionate distributions to its shareholders in taxable years b. Company represents that under its governing provisions, all of Company's shares of stock have possessed identical rights to distribution and liquidation proceeds since a. Company further represents that neither Company nor its shareholders knew that disproportionate distributions could terminate Company's S corporation election. Company will make Remedial Distributions to its shareholders upon the issuance of a favorable letter ruling.

Company represents that the circumstances resulting in the possible termination of its S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Further, Company and its shareholders have consistently treated Company as an S corporation and agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) provides that for purposes of title 26, 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 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.

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation

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 rights 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.

Section 1362(d)(2)(A) provides that 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. Section 1362(d)(2)(B) provides that any termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in 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 such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSIONS

Based solely on the facts submitted and representations made, we conclude that if Company's S corporation election was terminated for having more than one class of stock as a result of making disproportionate distributions, such termination constituted an inadvertent termination within the meaning of § 1362(f). Accordingly, Company will be treated as continuing to be an S corporation from a, and thereafter, provided that Company's S corporation election is not otherwise terminated under § 1362(d). This ruling is contingent upon Company making Remedial Distributions within 120 days of the date of this letter for taxable years b—taxable years in which it made disproportionate distributions to its shareholders. The shareholders of Company must include their pro rata shares of the separately stated and nonseparately computed items of income or loss of Company as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by Company as provided in

§ 1368. If Company fails to make such Remedial Distributions or Company's shareholders fail to treat themselves as described above, this ruling shall be null and void.

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 whether Company is otherwise eligible to be treated as an S corporation.

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

Under a power of attorney on file with this office, we are sending a copy of this letter to Company's authorized representatives.

Sincerely,

/s/

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes