

D3 =

D4 =

D5 =

Period =

Dear :

This letter responds to a letter dated August 30, 2013, and subsequent correspondence, submitted on behalf of X requesting a ruling under § 1362(f) of the Internal Revenue Code (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. X's S corporation election was terminated on D2, when stock in X was transferred to LLC, an ineligible shareholder. In addition, X stock was transferred to Trust on D3. X represents that Trust qualified as a qualified subchapter S trust ("QSST") under § 1361(d)(3), but its income beneficiary, who died on D4, failed to make a QSST election. On D5, LLC and Trust transferred the X stock they held to eligible shareholders.

X represents that the termination was not motivated by tax avoidance or retroactive tax planning. 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.

Finally, during Period, X made 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 it will make corrective distributions to rectify the disproportionate distributions made during Period to its shareholders.

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) defines a “small business corporation” as 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.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST’s beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST’s S corporation stock to which the election under § 1361(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term “qualified subchapter S trust” means a trust (A) the terms of which require that -- (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary’s death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

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(d)(2)(B) provides that any termination under § 1362(d) 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.

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), Example 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.

CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that the termination of X's S corporation election on D2 was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2 and thereafter, provided X's S corporation

election was valid and provided that the election was not otherwise terminated under § 1362(d). In addition, from D2 through D5, Members shall be treated as the owners of X stock in proportion to their ownership interests in LLC, and Trust will be treated as a QSST during the period for which it held X stock.

In addition, based solely on the 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 that X will make do 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 distributions and corrective distributions must be given appropriate tax effect. Under these circumstances, we conclude that X's S corporation election did not terminate because of the disproportionate distributions and the corrective distributions that X will make. This ruling is contingent upon X making corrective distributions so that each shareholder receives distributions proportionate to their interests in X from D1 and thereafter, within 120 days of the date of this letter. Failure to make such corrective distributions will render this ruling void.

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. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation or Trust's eligibility to be a QSST.

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, we are sending a copy of this letter to X's authorized representative.

The rulings contained in this letter are 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 rulings requested, it is subject to verification on examination.

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