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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact: \_\_\_\_\_, ID No. \_\_\_\_\_

Telephone Number:

Refer Reply To:  
CC:PSI:B02  
PLR-117357-14

Date:  
May 21, 2014

### Legend

$$\underline{X} =$$

State =

Date 1 =

Date 2 =

Year 1 =Year 2 =

Year 3 =

$$\underline{A} =$$

SSN:

B =

SSN:

Dear \_\_\_\_\_ :

This responds to a letter dated April 21, 2014, submitted on behalf of X by its authorized representative, requesting a ruling under subchapter S of the Internal Revenue Code.

The information submitted states that X was incorporated in State on Date 1. X made an election to be treated as an S corporation effective Date 2. From Year 1 to Year 2, X made disproportionate distributions to its shareholders, grantor trusts owned by A and B. X represents that it did not intend to create any differences in rights among the shares. In Year 3, X made corrective distributions to A eliminating the cumulative amount of the disproportionate distributions. As a result of the corrective distribution, the cumulative distributions from X to its shareholders are proportionate to stock ownership.

X represents that it did not intend to create a second class of stock. X and its shareholders consent to make such adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

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 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. Differences in voting rights among shares of stock of the corporation are disregarded for purposes of determining whether a corporation has more than one class of stock.

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.

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

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 regarding the validity of any § 338(h)(10) election. See Treas. Reg. § 1.338(h)(10)-1(c)(3).

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling will be sent to the taxpayer's representatives.

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.

Sincerely,

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

cc: