

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B03  
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Date:  
November 05, 2015

X =

State =

D1 =

D2 =

D3 =

D4 =

Year =

Dear :

This responds to a letter dated May 4, 2015, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

### FACTS

The information submitted states that X was incorporated under the laws of State on D1 and elected to be an S corporation effective D1. On D2, X filed restated articles of incorporation to authorize two classes of stock consisting of one class of voting common stock ("Voting Stock") and a second class of non-voting common stock ("Non-Voting Stock"). On a number of occasions beginning on D3, X sold shares of Non-Voting Stock to various individuals (the "Non-Voting Shareholders"). Each of the Non-Voting Shareholders also entered into an agreement (the "Subscription Agreement") with X, under which X maintained the right to redeem the Non-Voting Shareholders' shares at a redemption price in excess of the then-current fair market value of the Non-Voting shares (the "Redemption Right"). There was no such redemption right relating to the Voting Stock.

In Year, X became aware that the Redemption Right potentially caused the Non-Voting Stock to be a second class of stock that could terminate X's S corporation

election. On D4, each Non-Voting Shareholder agreed to revise his or her Subscription Agreement to modify the Redemption Right such that the redemption price would be equal to the fair market value of any redeemed shares at the time of redemption. X has not redeemed any Non-Voting Stock at any time, and therefore has not given effect to the Redemption Right either before or after its modification.

X represents that it was not aware that the Redemption Right possibly created a second class of stock that could terminate its S corporation election. X further represents that any termination of its S corporation election 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.

X requests a ruling that a termination of X's S corporation election due to the issuance of a possible second class of stock was inadvertent within the meaning of section 1362(f). Furthermore, notwithstanding the termination of its S corporation election, X requests that it will be treated as an S corporation from D3 and thereafter.

#### LAW AND ANALYSIS

Section 1361(a)(1) 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 one class of stock.

Section 1.1361-1(l)(1) 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).

Section 1.1361-1(l)(2)(iii)(A) provides that buy-sell agreements among shareholders, agreements restricting the transferability of stock, and redemption agreements are disregarded in determining whether a corporation's outstanding shares of stock confer identical distribution and liquidation rights unless (1) 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), and (2) the agreement establishes a purchase price that, at the time the agreement is entered into, is significantly in excess of or below the fair market value of the stock.

Section 1.1361-1(l)(2)(iii)(A) further provides that agreements that provide for the purchase or redemption of stock at book value or at a price between fair market value and book value are not considered to establish a price that is significantly in excess of or below fair market value of the stock and, thus, are disregarded in determining whether the outstanding shares of stock confer identical rights.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will 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(f) provides, in part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's S corporation election may have terminated on D3 as a result of X issuing more than one class of stock. Subsequent issuances of this stock between D3 and D4 could also have caused a termination. We further conclude that if X's S corporation election terminated, such termination was inadvertent within the meaning of § 1362(f).

X has taken corrective action so that it once again meets the requirements of a small business corporation under § 1361(b). Therefore, we determine that pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D3 and thereafter, provided that X's S corporation election was otherwise valid and, apart from the inadvertent termination ruling described above, has not otherwise terminated under § 1362(d).

Except as specifically set forth above, we express or imply no opinion as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether X is otherwise eligible to be an S corporation.

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 with this office, we will send a copy of this letter ruling to X's authorized representative.

The ruling contained in this letter is 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,

Holly Porter  
Chief, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures: 2  
Copy of this letter  
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