

Internal Revenue Service

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Department of the Treasury
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Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
 , ID No.

Telephone Number:

Refer Reply To:
CC:PSI:01
PLR-124279-17
Date:
February 01, 2018

Legend

X =

State =
Date 1 =
Date 2 =
Date 3 =
Agreement =

Dear :

This letter responds to a letter dated August 4, 2017, and subsequent correspondence submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

According to the information submitted, X was organized as a limited liability company under the laws of State on Date 1. Subsequently, X made an election to be treated as an S corporation effective Date 3.

Effective Date 2, X's shareholders signed an operating agreement, Agreement. Agreement includes provisions in contemplation of X being treated as a partnership for federal income tax purposes; however, the applicability of those provisions was not limited to such a situation. At the time of its S corporation election, Agreement included provisions that cause X to have more than one class of stock. The partnership provisions include Article 8, relating to capital contributions, capital accounts, and liability of members. In particular, Article 8(b) provides for the increase, decrease and maintenance of capital accounts in accordance with § 704 of the Code. Article 10

contains the provisions regarding the allocation of profits and losses and distributions to members. Article 10(a) provides for the allocation of X's profit and losses in accordance with member's vested capital accounts. Article 10(a) further provides the terms and conditions for X to make liquidating distributions to members with positive vested capital accounts, in accordance with such positive capital account balances, but only after the capital accounts have been adjusted to reflect all net profits or losses through the date of liquidation. Article 10(b) provides for the increase, decrease and maintenance of capital accounts in accordance with § 1.704-1(b)(2)(iv) of the Income Tax Regulations. The provisions in Agreement applied during the period when X intended to be treated as an S corporation, thereby creating the potential for a second class of stock under § 1361(b)(1)(D).

X requests a ruling that if certain provisions of Agreement cause X to have more than one class of stock for purposes of § 1361(b)(1)(D), then the resulting ineffectiveness or subsequent termination of X's S corporation election was inadvertent within the meaning of § 1362(f). X represents that it will amend the terms of its operating agreement to provide for equal rights to distributions, dividends, and liquidation proceeds. In accordance with §§ 1362(f) and 1.1362-4, X and each person who has been a shareholder of X at any time on or after Date 3 through the date of the ruling request have consented to any adjustments as may be required by the Secretary.

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 1.1361-1(l)(1) of the Income Tax Regulations provides, in part, 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 laws, and binding agreements relating to distribution and liquidation proceeds (collectively, governing provisions).

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(d)(2)(B) provides that the termination 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 such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, 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 ineffectiveness or 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 was ineffective because X had more than one class of stock due to the partnership provisions in Agreement. We also conclude that the invalidity of X's S election, as a result of Agreement creating a second class of stock, was inadvertent within the meaning of § 1362(f). Accordingly, under the provisions of § 1362(f), X will be treated as an S corporation effective on Date 3 and thereafter, provided that X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d).

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provisions of the Code. Specifically, we express or imply no opinion on whether X was otherwise eligible to be an S corporation. 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.

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. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to the X's authorized representatives.

Sincerely,

Wendy L. Kribell

Wendy L. Kribell
Assistant to the Branch Chief, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)
Copy of Letter
Copy for 6110 purposes

cc: