

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

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Date of Communication: Not Applicable

Person To Contact:  
 , ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:03  
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Date:  
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### Legend:

X =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Shareholder 6 =

Shareholder 7 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

a =

b =

c =

Dear :

This letter responds to a letter dated October 11, 2017 submitted on behalf of X by its authorized representative requesting a ruling under §1362(f) of the Internal Revenue Code (Code).

### FACTS

The information submitted states that X was formed under the laws of State on Date 2 and was authorized to issue a shares of common stock. Shortly after Date 2, X issued all of its authorized shares to Shareholders 1-6.

X timely filed Form 2553, Election by a Small Business Corporation, to make an election to be treated as an S corporation after Date 2 but on or before the 15<sup>th</sup> day of the third month of its first taxable year beginning on Date 2. X intended to make its S election effective Date 2, but its Form 2553 specified a Date 1 effective date, which proceeded X's formation. Since Date 2 X acted as if it was an S corporation.

On Date 3, X issued b additional shares of common stock to Shareholders 1-6. On Date 4, X, by amendment to its articles of incorporation, authorized a additional shares, but did not file a certificate of amendment with its Secretary of State as required by law. On Date 5, X issued c shares to Shareholder 7.

After the discovery of the errors, on Date 6, X took remedial action by filing the certificate of amendment with its Secretary of State. The remedial action made the

previously unauthorized shares authorized and validly issued.

X represents that its governing provisions provide for one class of stock, that all of its authorized, issued, and outstanding shares of stock confer identical rights to distribution and liquidation proceeds, and that it did not intend to create a second class of stock or terminate its S election. X also represents that if its S election was terminated, such termination was inadvertent and not motivated by tax avoidance or retroactive tax planning. In addition, X and its shareholders agree to make any adjustments required by the Commissioner consistent with the treatment of X as an S corporation.

### 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 the 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 law, and binding agreements relating to distribution and liquidation proceeds (collectively, 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)(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) further provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in relevant part, 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.

#### CONCLUSION

Based on the facts submitted and the representations made, we conclude X's S election was effective Date 2. If any rights conferred by State law upon the issued but unauthorized stock of X differed in rights to distribution and liquidation proceeds from the issued and authorized stock, X may have had more than one class of stock upon issuance of the unauthorized stock. Accordingly, X's S election may have terminated. We conclude that if such a termination occurred it was inadvertent within the meaning of §1362(f). Thus, X will be treated as continuing to be an S corporation from Date 2 and thereafter, provided X's S corporation election was otherwise valid and has not otherwise terminated under §1362(d). However, disproportionate and corrective distributions must be given appropriate tax effect.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code.

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

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 ruling request, it is subject to verification on examination.

Pursuant to a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

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Bradford R. Poston  
Special Counsel to the Associate Chief Counsel  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

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

cc: