

Internal Revenue Service

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Date:
November 15, 2018

LEGEND

X =

Y =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Operating Agreement =

Dear _____ :

This letter responds to a letter dated June 5, 2018, submitted on behalf of X (successor to Y) by X's authorized representative, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted, Y was organized as a limited liability company under the laws of State on Date 1. Subsequently, Y made an election to be treated as association and an election to be treated as an S corporation effective Date 2.

Y's shareholders signed an operating agreement, Operating Agreement on Date 3. Section 10 of Y's Operating Agreement provided that, "Upon dissolution of the Company...the proceeds from the liquidation of the Company's assets shall be distributed...to the Members in accordance with their respective positive Capital Account Balances; and, the balance, if any, to the Members, in accordance with their respective Percentage Interests."

On Date 4, Y undertook a reorganization under § 368(a)(1)(F), in which Y transferred all shares of ownership interests into X, a corporation created on Date 4 under the laws of State. X then filed a Form 8869, *Qualified Subchapter S Subsidiary Election*, to treat Y as a qualified subchapter S subsidiary, effective Date 4. Subsequently, X became the successor to Y for federal income tax purposes. Consistent with Rev. Rul. 2008-18, 2008-1 C.B. 674, X has been treated as the successor S corporation to Y for federal income tax purposes and therefore did not make a new S corporation election. After the reorganization, Y filed a Form 8832, *Entity Classification Election*, to be disregarded as a separate entity for federal income tax purposes, effective Date 5. Y's Operating Agreement was effectively replaced by X's corporate charter, which X represents provides for a single class of stock.

While reviewing the reorganization during Year, outside counsel became concerned that Operating Agreement implemented by Y on Date 3 allowing for disproportionate distributions to shareholders created a second class of stock.

Y and its successor, X, represent that the termination of the S corporation election was inadvertent and not the result of tax avoidance or retroactive tax planning. Y and its successor, X, further represent that no federal tax return of any person has been filed inconsistent with a valid S corporation election having been made for Y and its successor, X, effective Date 2. Y and its successor, X, also represent that all distributions and allocations of income to its shareholders have been made pro rata in accordance with their interests in both Y and its successor, X. Y its successor, X, and its shareholders have agreed to make any adjustments required by the Service consistent with the treatment of Y and its successor, 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 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.

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).

Section 1.1362-4(b) provides that for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination was inadvertent.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that Y's S corporation election terminated on Date 3 for having more than one class of stock due to the provisions in the Operating Agreement. We also conclude that the circumstances resulting in the termination of Y's S corporation election were inadvertent within the meaning of § 1362(f). Thus, under the provisions of § 1362(f), Y and its successor, X, will be treated as an S corporation effective Date 3, and thereafter, provided that Y and its successor, 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 described above under any other provision of the Code. In particular, we express or imply no opinion regarding the taxpayer's eligibility to be an S corporation. In addition, we express or imply no opinion on whether the conversions on Date 4 qualified as F reorganizations within the meaning of § 368(a)(1)(F).

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,

By: David R. Haglund
David R. Haglund
Branch Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy of this letter for section 6110 purposes