Internal Revenue Service

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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:01
PLR-110363-21

Date:
August 30, 2021

Legend

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Agreement 1 =

Agreement 2 =

Agreement 3 =

Dear :

This letter responds to a letter dated April 21, 2021, submitted on behalf of Company by its authorized representative, requesting a ruling under § 1362(f) of the Internal

Revenue Code (Code).

Facts

The information submitted states that Company was organized under the laws of State on Date 1 as a limited liability company. Company was originally treated as a partnership for Federal tax purposes. Effective Date 2, Company elected to be an association treated as an S corporation.

Effective on Date 3, Company adopted an operating agreement, Agreement 1. Agreement 1 included provisions in contemplation of Company being treated as a partnership for federal income tax purposes; however, the applicability of those provisions was not limited to such a situation. Agreement 1 included the following partnership provisions: (1) Section 7.5 providing for the maintenance of capital accounts, the definition of which requires that the capital accounts be increased, decreased, and otherwise maintained in accordance with § 1.704-1(b)(2)(iv) of the Income Tax Regulations; (2) Section 7.6(a) providing that any allocations with respect to property whose value differs from its tax basis "be allocated for federal income tax purposes to the Interest Holders under Code § 704(b) and (c)"; (3) Sections 7.1 and 7.2 providing that, after regulatory allocations (which include allocations made pursuant to § 1.704-2, § 1.704-1(b)(2)(ii), and general curative allocations), profits and losses, are, in general, allocated among Interest Holders in proportion to their Units, except that losses may not create or increase a capital account deficit; (4) Section 7.3 providing, in part, that distributions must be made, at minimum, to pay the Interest Holders' tax liabilities attributable to the Company's income and that all distributions "must be allocated in proportion to Unit ownership, unless the Members otherwise determine by Majority Vote"; and (5) Section 14.2 providing that liquidating distributions shall be made "to Interest Holders in accordance with positive Capital Account balances taking into account all Capital Account adjustments for the Company's taxable year in which the liquidation occurs."

Effective on Date 4, Company adopted another operating agreement, Agreement 2. Agreement 2 included provisions in contemplation of Company being treated as a partnership for federal income tax purposes; however, the applicability of those provisions was not clearly limited to such a situation. Agreement 2 included the following partnership provisions: (1) Section 7.4 providing for the maintenance of capital accounts and Regulatory Allocations (which are not defined); (2) Section 7.3 providing, in part, that distributions must be made, at minimum, to pay the Interest Holders' tax liabilities attributable to the Company's income, and that all distributions "must be allocated in proportion to Unit ownership, unless the Members otherwise determine by Super Majority Vote"; and (3) Section 14.2 providing that liquidating distributions shall be made "to Interest Holders in accordance with positive Capital Account balances taking into account all Capital Account adjustments for the Company's taxable year in which the liquidation occurs."

On Date 5, Company adopted Agreement 3, which Company represents does not create a second class of stock.

Company represents that the terminations of its S election were inadvertent and was not motivated by tax avoidance or retroactive tax planning. Company also represents that Company and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) of the Code that may be required by the Secretary. Company and its shareholders represent that they have filed all returns consistent with Company being an S corporation.

Law and Analysis

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

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) 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) shall 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) 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 (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 the discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken so that the corporation for which the election was made or the termination occurred is a small business corporation, and (4) the corporation for which the election was made or the termination occurred, 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 representations made, we conclude that Company's S election was terminated on Date 3 because Company had more than one class of stock due to the partnership provisions in Agreement 1. If Company's S election hadn't terminated on Date 3, Company's S election would have terminated on Date 4 because Company had more than one class of stock due to partnership provisions in Agreement 2, which was effective on Date 4.

We also conclude that the termination of Company's S election as a result of Agreement 1 and Agreement 2 creating a second class of stock was inadvertent. Accordingly, under § 1362(f), Company will be treated as an S corporation from Date 3, and thereafter, provided the S election for Company is otherwise valid and has not terminated under § 1362(d).

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. Specifically, no opinion is expressed or implied concerning whether X otherwise qualifies as an S corporation for federal tax purposes.

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,

Caroline E. Hay

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Caroline E. Hay
Senior Counsel, Branch 1
(Passthroughs and Special Industries)

Enclosure:
Copy for §6110 purposes

cc: