

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **202209001**

Release Date: 3/4/2022

Index Number: 1361.01-04, 1361.01-05,
1362.02-02, 1362.04-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:01
PLR-103324-21

Date:
September 09, 2021

Legend

Company =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Agreement 1 =

Agreement 2 =

Dear _____ :

This letter responds to a letter dated January 29, 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 corporation and elected to be treated as an S corporation effective Date 1.

Effective on Date 2, Company converted to a limited liability company and continued to be treated as a corporation for federal income tax purposes. 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 3.6 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) of the Income Tax Regulations; (2) Section 4.8 providing that, “[i]n accordance with Code Section 704(c) and the Regulations thereunder, income, gain, loss, and deduction with respect to any property contributed to the capital of the Company shall, solely for tax purposes, be allocated among the Members to as to take account of any variations between adjusted basis of such property to the Company for federal income tax purposes and its initial Gross Asset Value”; (3) Section 4.2 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 Members in proportion to their respective Company Units, except that, pursuant to Section 4.5, losses may not create or increase a capital account deficit; (4) Section 4.1 providing, in part, that distributions must be made, at minimum, in an amount equal to the lesser of all available Net Cash Flow or a percentage of Company net taxable income equal to the highest marginal tax effected state and federal income tax rates applicable to any Member; and (5) Section 11.2 providing that liquidating distributions shall be made “to Members in proportion to and to the extent of their positive Capital Account balances, after giving effect to all contributions, distributions and allocations for all periods.”

On Date 4, 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.

We also conclude that the termination of Company's S election as a result of Agreement 1 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).

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. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

_____/s/
Laura Fields
Chief, Branch 1
(Passthroughs and Special Industries)

PLR-103324-21

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Enclosure:

Copy for §6110 purposes

cc: