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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:B01

PLR-102687-23

Date:

August 03, 2023

LEGEND

X =

A =

B =

Agreement1 =

Agreement2 =

Date1 =

Date2 =

Date3 =

Year1 =

Year2 =

Year3 =

State =

Dear :

This letter responds to a letter dated February 1, 2023, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (Code).

FACTS

According to the information submitted, X is a limited liability company organized under the laws of State on Date1. X filed an election to be treated as an S corporation pursuant to IRC Section 1362(a), to be effective Date2.

On Date3, A and B executed Agreement1, and X simultaneously issued shares of X to B. The terms of Agreement1 did not provide for identical rights to distribution and liquidation proceeds. Specifically, Agreement1 contained partnership provisions such as, in Section 10.4 of the agreement, that distributions would be provided to members "in proportion to their capital accounts, until all capital accounts had been reduced to zero." Only after this step were proceeds distributed to members in accordance with their respective percentages of membership interest. Article 14 further provides for, in the case of a liquidation of the taxpayer, property first be distributed to the members in accordance with their capital account balance. These provisions of Agreement1 caused X to have more than one class of stock under § 1361(b)(1)(D), and therefore terminated X's S election as of Date3. X also made disproportionate distributions to A and B during Year1, Year2, and Year3.

X represents that it executed an amended operating agreement (Agreement2) that eliminated the provisions that caused X to have more than one class of stock.

X represents that the circumstances surrounding the termination of X's S corporation election were inadvertent and not the result of tax avoidance or retroactive tax planning. X further represents that for each taxable year beginning Date2, X and its shareholders have filed consistently with X being an S corporation. In addition, X and its shareholders agree to make any adjustments that may be required by the Secretary as a condition of obtaining relief under § 1362(f).

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 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, in part, 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 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect to be an S corporation.

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 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), (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 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 solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated as of Date3 because X had more than one class of stock. We conclude, however, that the circumstances that caused this S election to terminate were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as an S corporation Date3 and thereafter, provided that its S corporation election was otherwise valid and has not otherwise terminated under § 1362(d).

This ruling is contingent on X taking remedial steps to make corrective distributions to its shareholders to eliminate the cumulative amount of the disproportionate distributions made by X to its shareholders.

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, we express or imply no opinion on whether X was or is 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. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

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

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

Sincerely,

Caroline E. Hay
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: