

**Internal Revenue Service**

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Refer Reply To:

CC:PSI:B03

PLR-154348-04

Date:

March 01, 2007

X =

A =

B =

C =

D =

E =

F =

G =

State =

Date1 =

Date2 =

Date3 =

Year1 =

Year2 =

Dear \_\_\_\_\_ :

This letter responds to a letter dated October 13, 2004, and subsequent correspondence submitted on behalf of X by X's authorized representative, requesting a ruling regarding X's status as an S corporation.

The information submitted states that X is a corporation incorporated under the laws of State on Date1. X elected to be an S corporation effective Date1. At the time of incorporation, A and B were shareholders of X. Since that time, C, D, E, F, and G have been added as shareholders.

X represents that, in accordance with X's governing instruments (Articles of Incorporation and By-laws) and State law, all of X's issued and outstanding shares have had identical rights to liquidation and distribution proceeds since Date1. Furthermore, X represents that X does not have an agreement (written or oral) or any other type of understanding with any shareholder that would entitle any shareholder to a preference regarding X's distribution and liquidation proceeds.

Although X's chief financial officer (CFO) properly made actual distributions from Year1 through Year2 in accordance with the ownership interests of the shareholders, the CFO also caused X to make additional distributions to the shareholders in order to allow the shareholders to meet their quarterly and/or annual tax liabilities. These distributions were not in proportion to the ownership interests of the shareholders. The CFO was not aware that such distributions would create disproportionate distributions that could terminate X's S election.

In late Year2, X hired a new Executive Director-Finance and retained its current CPA firm for audit, tax preparation and tax compliance services. During initial meetings, X's advisors informed X that prior disproportionate distributions were not consistent with X's governing instruments and could create more than one class of stock. On Date2, X's Board of Directors adopted a plan for corrective distributions to be in effect until the cumulative amount of disproportionate distributions were eliminated. On Date3, the final corrective distributions were made, eliminating the cumulative amount of disproportionate distributions.

Section 1361(a)(1) of the Internal Revenue Code 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 that year.

Section 1361(b)(1)(D) provides that a small business corporation cannot have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that, except as provided in § 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is 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. Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock.

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. 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.

Based solely on the representations made and the information submitted, we conclude that because X's stock has identical distribution rights under its governing provisions, the difference in timing between X's disproportionate distributions and the corrective distributions to shareholders did not cause X to have more than one class of stock for purposes of § 1361(b)(1)(D). However, such disproportionate and corrective distributions must be given appropriate tax effect. Under these circumstances, we conclude that X's S election did not terminate because of the disproportionate and corrective distributions.

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation for federal income tax purposes.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

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.

Sincerely,

/s/

Christine Ellison,  
Chief, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

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