

Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-120266-18
Date:
November 19, 2018

LEGEND:

X =

State =

Date 1 =

Date 2 =

A =

B =

C =

Date 3 =

g =

h =

Date 4 =

Agreement =

Date 5 =

Amendment

Dear _____ :

This letter responds to a letter dated June 21, 2018, and subsequent correspondence, submitted on behalf of X requesting rulings under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on Date 1, and elected to be treated as an S corporation effective Date 2. X has outstanding voting and non-voting shares of the same class of common stock. Other than the difference in voting rights, there is no difference between the voting and non-voting shares of common stock. A, B, and C have been the only shareholders of X since Date 3; A and B each own g% of the shares and C owns h% of the shares.

On Date 4, X's shareholders entered into Agreement. Agreement provided that: (1) if a shareholder's voting stock is sold, a corresponding percentage of such shareholder's non-voting stock must be cancelled, and in the event that the remaining shareholders have other than equal ownership of the remaining shares of non-voting stock, those shareholders would be entitled to distributable earnings pro rata in accordance with the shares of non-voting stock; and (2) in the event of a sale of X, C would be entitled to receive from the proceeds a payment in excess of the payments to A and B. On Date 5, the Agreement was amended to remove these two provisions. No shares of X were sold between Date 4 and Date 5.

X represents that the circumstances resulting in the possible termination of X's S corporation election were inadvertent and not motivated by tax avoidance. X further represents that since Date 2, X and its shareholders have filed all returns consistent with X's status as an S corporation. X and its shareholders have agreed to make such adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

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 such 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 generally 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. Thus, if all shares of stock of an S corporation have identical rights to distribution and liquidation proceeds, the corporation may have voting and nonvoting common 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 (collectively, the governing provisions). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding agreement relating to distribution and liquidation proceeds and thus is not a governing provision unless a principal purpose of the agreement is to circumvent the one class of stock requirement of § 1361(b)(1)(D) and § 1.1361-1(l).

Section 1362(d)(2) provides that (A) in general, 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 and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides 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 for which the election was made or the termination occurred is a small business corporation or (B) to acquire the shareholder consents, 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 representations made, we conclude that X's S corporation election terminated on Date 4 due to the provisions in the Agreement. However, we conclude that such termination was inadvertent within the meaning of § 1362(f). Therefore, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 4 to Date 5 and thereafter, provided that X is otherwise eligible to be an S corporation and provided that the election was not otherwise terminated.

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. In particular, no opinion is expressed on whether X otherwise qualifies as an S corporation.

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 representatives.

Sincerely,

David R. Haglund

David R. Haglund
Branch Chief, Branch 1
(Passthroughs & Special Industries)

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

cc: