

Internal Revenue Service

Department of the Treasury
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B3
PLR-114756-20
Date:
December 9, 2020

Legend:

X =

A =

B =

C =

Agreement 1 =

Agreement 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Years =

Dear :

This letter responds to a letter dated June 29, 2020, and subsequent correspondence, submitted on behalf of X by its authorized representatives requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

Facts

The information submitted states that X was organized on Date 1 as a limited liability company under the laws of State and elected to be an S corporation effective Date 2. A was the sole member of X on Date 2. On Date 3, pursuant to an employment agreement, X issued restricted membership units to B. B did not make an election under § 83(b) with respect to those units. B's restricted membership units in X began vesting on Date 4. On Date 5, pursuant to an employment agreement, X issued restricted membership units to C. C did not make an election under § 83(b) with respect to those units. C's restricted membership units in X began vesting on Date 6.

X's operating agreement that was in effect on Date 4 and Date 6, Agreement 1, contained terms causing X to have more than one class of stock under § 1361(b)(1)(D). Provisions in Agreement 1, including partnership provisions that applied irrespective of whether X was a partnership, failed to confer identical rights to distribution and liquidation proceeds. For instance, section 10.5 of Agreement 1, provided, in part, that in the event X is liquidated within the meaning of § 1.704-1(b)(2)(ii)(g) of the Income Tax Regulations, distributions shall be made to the members who have positive capital accounts in compliance with § 1.704-1(b)(2)(ii)(b)(2).

Once X learned its S corporation election terminated on Date 4, it amended and restated its operating agreement effective Date 7 (Agreement 2) to remove the terms in Agreement 1 causing X to have more than one class of stock under § 1361(b)(1)(D).

In addition, during Years, X made distributions to A, but failed to make proportionate distributions to B and C. X has since made correcting distributions to B and C.

X represents that the circumstances resulting in the termination of its S corporation election under § 1362(f) were inadvertent and not motivated by tax avoidance or retroactive tax planning. X states that X and its shareholders have filed their federal income tax returns consistent with X having a valid S corporation election in effect. X and its shareholders have agreed to make 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) 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(b)(3) provides that for purposes of subchapter S, stock that is issued in connection with the performance of services (within the meaning of § 1.83-3(f)) and that is substantially nonvested (within the meaning of § 1.83-3(b)) is not treated as outstanding stock of the corporation, and the holder of that stock is not treated as a shareholder solely by reason of holding the stock, unless the holder makes an election with respect to the stock under § 83(b).

Section 1.1361-1(l)(1) provides, in part, that a corporation that has more than one class of stock does not qualify as a small business corporation. 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.

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, the governing provisions). 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.

Section 1362(a)(1) 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 1362(d)(2) 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. Any termination under § 1362(d)(2) is 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 was terminated under § 1362(d)(2); (2) the Secretary determines that the circumstances resulting in the termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which 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 termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based on the representations made and information submitted, we conclude that X's S corporation election terminated on Date 4 because X had more than one class of stock due to the partnership provisions in Agreement 1. We conclude, however, that the circumstances resulting in the termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), X will be treated as an S corporation from Date 4 and thereafter provided that X's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d).

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3) of the Code, 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.

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: