Internal Revenue Service

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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:03
PLR-120410-20

Date:
March 19, 2021

Legend:

Company: =

State: =

Date 1: =

Date 2 =

Date 3 =

Date 4 =

Years =

Dear :

This letter responds to a letter dated September 14, 2020, and subsequent correspondence submitted on behalf of Company by its authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states Company was organized on Date 1, as a limited liability company under the laws of State. On Date 2, Company elected to be an S corporation effective for Date 3.

On Date 4, the Company adopted an operating agreement ("Agreement") that 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. The Agreement included the following partnership provisions:

1.2.4. "Capital Account" of a Member means the capital account maintained for the Member in accordance with Article 3.6.

1.2.5. "Capital Unit" means any Unit that would give the holder thereof a share of the proceeds if the Company's assets were sold at fair market value (determined as of the date on which such Unit is received) and then the proceeds were distributed in a complete liquidation of the Company.

1.2.15. "Profits Interest" represents an interest in Company profits and losses from operations, distributions from operations and an interest in future appreciation or depreciation in Company asset values but which does not represent an interest in any existing capital of the Company (as described in Revenue Procedure 93-27, 1993-2 C.B. 343 and Revenue Procedure 2001-43.2001-2 C.B. 191.

1.2.16. "Profits Interest Unit" means, as of any date of determination of the number of outstanding Profits Interest Units, that portion of an outstanding Profits Interest that entitles the holder thereof to receive distributions from the Company equal to the distributions to which the holder of one Unit is then entitled to receive pursuant to this Agreement.

3.1. Initial Capital Contributions. The Members shall make capital contributions to the Company, in cash, services, or property, in the amounts set forth in the attached Exhibit A.

3.2. Members' Units in Company Capital. The interest of each Member in the capital of the Company shall be equal to such Member's Membership Interest, which is comprised of part or all of one or more Units. As of the date of this Agreement, the Units are allocated among the Members as set forth on Exhibit A.

3.3.1. Profits Interest Units. This Article 3.3 shall constitute a written compensation plan and agreement within the meaning of Rule 701 under the Securities Act of 1933, as amended (the "1933 Act"), and under State law pursuant to which Profits Interests may be issued as determined by the Managers, for zero consideration in order to align the interests of the holders of Profits Interest Units with the interests of

the other Members and to provide an additional incentive for the holders of Profits Interest Units to build value for the Company and achieve its business goals. The provisions of this Article 3.3 shall apply to any issuance of Profits Interest Units, as determined by the Managers in accordance with the terms of this Agreement. A holder of a Profits Interest Unit is a Member for all purposes of this Agreement.

3.3.2. Profits Interest Grants. The Profits Interest Units be [sic] issued pursuant to a profits interest grant agreement in substantially the form attached hereto as Exhibit B (with such modifications as the Managers may determine, the "Profits Interest Grant Agreement"). Each Member who receives a Profits Interest Unit is willing to subject each such Profits Interest Unit to the terms and conditions of the Profits Interest Grant Agreement.

3.3.3. Capital Account. It is intended that the Profits Interest Units will participate in distributions pari passu with the Capital Units; provided, however, that each holder of a Profits Interest Unit will have an initial zero balance in its Capital Account as of the date of grant (the "Grant Date') with respect to such interest in the Company. Because each holder of Profits Interest Units has a zero balance in his Capital Account as of the Grant Date, each holder of Profits Interest Units would not be entitled to a share of the proceeds if the Company assets were sold at fair market value as of the Grant Date or any date before the Grant Date and the proceeds were distributed in a complete liquidation of the Company. The number of Profits Interest Units granted to a holder shall be set forth on Exhibit A, which may be amended by the Managers from time to time without any additional consent of the Members.

3.3.4. Tax Liability. With respect to each holder of Profits Interest Units, the Company will treat each such holder of Profits Interest Units as the owner of all of the Profits Interest Units granted to such holder from each applicable Grant Date for all federal income tax purposes and such holder will take into account his distributive share of the Company's items of income, gain, loss, deduction, and credit associated with such interest in computing such holder's federal income tax liability for the entire period during which the holder has Profits Interest Units.

3.7. Capital Accounts of the Members. A separate Capital Account shall be maintained for each Member in accordance with the Code and the Regulations thereunder. Capital Accounts will be:

3.7.1. Increased by: (i) the amount of any money the Member contributes to the Company's capital; (ii) the fair market value of any property the Member contributes to the Company's capital, net of any liabilities the Company assumes or to which the property is subject; and (iii) the Member's share of Profits and any separately stated items of income or gain; and

3.7.2. Decreased by: (i) the amount of any money the Company distributes to the Member; (ii) the fair market value of any property the Company distributes to the Member, net of any liabilities the Member assumes or to which the property is subject;

and (iii) the Member's share of Losses and any separately stated items of deduction or loss.

3.8. Revaluation of Capital Accounts Upon Occurrence of Certain Events. In accordance with the provisions of the Regulations, if, after the initial capital is contributed pursuant to Article 3.1, money or property in other than a de minimis amount is contributed to the Company, or distributed by the Company to a Member, the Capital Accounts of the Members and carrying values of all the Company's property may be adjusted to reflect the fair market value of the company property on the date of adjustment, as set forth in the Regulations.

4.1. Allocation of Profits and Losses Between the Members. After giving effect to the special allocations contained in Article 4.2 and any others required to be made by the Code or the Regulations, Profits and Losses for each tax year shall be allocated between the Members in proportion to their Membership Units.

4.2. Special Allocations. Notwithstanding anything to the contrary contained herein. the following special allocations shall be made if the circumstances require.

4.2.1. Qualified Income Offset. Notwithstanding anything to the contrary contained herein, if a Member unexpectedly receives any adjustments, allocations, or distributions described in Section 1.704-1(b)(2)(ii)(d)(4), (5), or (6) of the Regulations or any amendment thereto, or receives an allocation of loss which produces a negative Capital Account for any Member while any other Member has a positive Capital Account, then items of Company income, including gross income, shall be specially allocated to such Member to the extent necessary to eliminate any Capital Account deficit. This article is intended to constitute a "qualified income offset" within the meaning of Section 1.704-1(b)(2)(ii)(d) of the Regulations.

4.2.2. Minimum Gain Chargeback. Notwithstanding anything to the contrary contained herein. if there is a net decrease in Company "minimum gain," as defined in Sections 1.704-2(b)(2) and 1.704-2(d) of the Regulations, during a taxable year, each Member shall be specially allocated, before any other allocation, items of income and gain for such taxable year (and, if necessary. subsequent years) in proportion to each Member's share of the net decrease in Company "minimum gain." This article is intended to comply with the "minimum gain chargeback" provisions of Section 1.704-(2)(1) of the Regulations.

4.2.3. Section 704(c) Allocation. Notwithstanding anything to the contrary contained herein, items of income, gain, loss, and deduction with respect to property contributed to the Company's capital will be allocated between the Members so as to take into account any variation between book value and basis, to the extent and in the manner prescribed by Section 704(c) of the Code and related Regulations.

4.2.4. Member Nonrecourse Deductions. Items of the Company's loss, deductions, and expenditures described in Section 705(a)(2)(B) of the Code that are

attributable to the Company's nonrecourse debt and are characterized as Member nonrecourse deductions under Section 1.704-2(i) of the Regulations will be allocated to the Members Capital Accounts in accordance with Section 1.704-2(i) of the Regulations.

4.2.5. Adjustments for Special Allocations. If the special allocations result in Capital Account balances that are different from the Capital Account balances the Members would have had if the special allocations were not required. The Company will allocate other items of income, gain, loss, and deduction in any manner it considers appropriate to offset the effects of the special allocations on the Members' Capital Account balances. Any offsetting allocation required by this article is subject to and must be consistent with the special allocations.

4.3. Tax Allocations. For federal income tax purposes, unless the Code or Regulations require otherwise, each item of the Company's income, gain, loss, or deduction will be allocated to the Members in proportion to their allocations of the Company's Profit or Loss.

4.5. Substantial Economic Effect. The various provisions of this article are intended and will be construed to ensure that the allocations of the Company's income, gain, losses, deductions, and credits have substantial economic effect under the Regulations promulgated under Section 704(b) of the Code.

10.4. Tax Matters Partner. The Members shall designate a Member to be the "Tax Matters Partner" of the Company pursuant to Section 6231(a)(7) of the Code. The Member so designated is authorized to take such actions as are permitted by Sections 6221 through 6233 of the Code. The initial Tax Matters Partner shall be . The Tax Matters Partner may be removed by the Members at any time with or without cause. A Member is eligible to serve as the Tax Matters Partner only if the Member (or, if a revocable trust is a Member. the trustor of such trust) is then serving as a Manager, or no Member is then serving as a Manager. The Tax Matters Partner will inform the Members of all administrative and judicial proceedings pertaining to the determination of the Company's tax items and will provide the Members with copies of all notices received from the Internal Revenue Service regarding the commencement of a Company-level audit or a proposed adjustment of any of the Company's tax items. The Tax Matters Partner may extend the statute of limitations for assessment of tax deficiencies against the Members attributable to any adjustment of any tax item. The Company will reimburse the Tax Matters Partner for reasonable expenses properly incurred while acting within the scope of the Tax Matters Partner's authority.

11.3.3. Duties and Authority of Liquidator. The liquidator will make adequate provision for the discharge of all of the Company's debts. obligations, and liabilities (including liabilities to Members who are creditors). The liquidator may sell, encumber, or retain for distribution in kind any of the Company's assets. Any gain or loss recognized on the sale of assets will be allocated to the Members' Capital Accounts in accordance with the provisions of Article 4.1. With respect to any asset the liquidator determines to retain for distribution in kind, the liquidator will allocate to the Members·

Capital Accounts the amount of gain or loss that would have been recognized had the asset been sold at its fair market value.

11.3.4. Final Distribution. The liquidator will distribute any assets remaining after the discharge or accommodation of the Company's debts, obligations. and liabilities to the Members in proportion to their positive Capital Account balances. Notwithstanding the foregoing, distributions made pursuant to this Article 11.3.4 shall in all cases take into account any adjustments to the Capital Accounts of the Members required under Article 3.7 and as otherwise may be required under any other provision of this Agreement, the Code, or any guidance issued by the Internal Revenue Service, as determined by the Managers in their reasonable discretion, to ensure that any Member holding Profits Interest Units (i) receives in respect of such Profits Interest Units only amounts economically earned by the Company after receipt of such Profits Interest Units by such Member, and (ii) does not in respect of such Profits Interest Units share in any amount that would have been distributed by the Company if, immediately after the receipt of such Profits Interest Units by such Member, the Company's assets were sold for their fair market values and the proceeds (net of any liabilities of the Company) were then distributed in a complete liquidation of the Company. The liquidator will distribute any assets distributable in kind to the Members in undivided interests as tenants in common. A Member whose Capital Account is negative will have no liability to the Company, the Company's creditors, or any other Member with respect to the negative balance.

Company represents that Company and its shareholders have filed tax returns consistent with Company having a valid S corporation election in effect as of Date 3. Company and its shareholders represent that Company and its shareholders will file amended returns for Years as needed to reflect units that vested in Years and as necessary to reflect additional income and taxes resulting from the vesting of those units. Company also represents that it will amend Agreement to provide for identical rights to distribution and liquidation proceeds in accordance with § 1.1361-1(l). Company further represents that the circumstances that led to the termination of its S election were inadvertent and not motivated by tax avoidance. Company and each person who has been a shareholder of it at any time on or after Date 3, through the date of this request have consented to any adjustments as may be required by the Secretary.

Company requests relief pursuant to § 1362(f) due to its governing provisions creating more than one class of stock.

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 for purposes of subchapter S, the term "small business corporation" means a domestic corporation, which is not an ineligible

corporation and does not have (A) 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 subsection § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1.1361-1(l)(1) 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(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)(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(f) provides, in part, that if (1) an election under § 1362(a) by any corporation (i) 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 (ii) was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such 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), agree to make the adjustments (consistent with the treatment of the corporation as an S corporation as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall 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 the termination of Company's S election as a result of Agreement creating a second class of stock was inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), Company will be treated as an S corporation from Date 3, and thereafter, provided the S

election for Company was otherwise valid on Date 3 and has not otherwise terminated under § 1362(d).

Except as specifically ruled above, we express or imply no opinion as to the federal income tax consequences of the facts described above under any other provision of the Code, including Company's eligibility to be a valid S corporation.

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.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Pursuant to the power of attorney on file, a copy of this letter is being sent to Company's authorized representative.

Sincerely,

Associate Chief Counsel
(Passthroughs & Special Industries)

By: _____
Wendy Kribell
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: