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-101968-21

Date:
July 22, 2021

Legend

Company =

State =

Date 1 =

Date 2 =

Date 3 =

Agreement 1 =

Agreement 2 =

Dear :

This letter responds to a letter dated December 15, 2020, submitted on behalf of Company by its authorized representative, 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. At all times Company has had two owners, and until Date 2 was treated as a partnership. Upon organization Company adopted Agreement 1 which included provisions treating Company as a partnership for Federal income tax purposes. Agreement 1 included the following partnership provisions:

Section 5.3, Formula for Allocations of LLC Profits and Losses Among the Members

The LLC shall allocate its profits and losses to Members in proportion to their respective contributions to the LLC unless otherwise agreed by all of the Members.

a. Allocations in Respect of Contributed Non-Cash Property. If a Member makes a contribution of non-cash property to the LLC, the LLC shall allocate its income, gains, deductions, losses and other tax items to the Member in respect of this contribution in accordance with Internal Revenue Code Section 704 (c) (1) (A) and regulations thereunder.

b. Allocations Disproportionate to Capital Contributions. If the LLC allocates any of its profits and losses to a Member in a manner that is disproportionate to the Member's share of LLC contributions, the LLC shall make this allocation in compliance with the requirements of Internal Revenue Code Section 704(b) and the regulations thereunder.

Section 5.5, Formula for Allocations of Interim Distributions Among the Members

The LLC shall allocate Interim Distributions among Members in accordance with the same formula on the basis of which it allocates its profits and losses among them.

Section 5.9, Payments and Distributions of LLC Assets in Connection with Liquidation

Upon completion of the LLC's winding up, and, to the extent reasonably practicable, on or before the date of termination of the LLC's legal existence, the LLC shall (subject to any applicable provisions of Section 704 (b) of the Internal Revenue Code and other applicable federal and state law) pay out its assets in connection with its liquidation as follows:

a. Payment of Creditors. First, the LLC shall pay (or shall make adequate provision to pay) its creditors.

b. Distributions to Members of Allocated Assets. Second, the LLC shall distribute its assets to Members in satisfaction of its liabilities for Interim Distributions to them under this Agreement.

c. Distributions to Members to Return Their Contributions. Third, the LLC shall distribute its assets to Members for the return of their contributions.

d. Distributions in Accordance with Section 5.3. Fourth, the LLC shall distribute its assets to Members in accordance with the allocation formula set forth in Section 5.3.

Effective Date 3, Company elected to be treated as an S Corporation for Federal income tax purposes. Agreement 1 created a second class of stock, causing Company's S corporation status to be void ab initio. Upon learning that Agreement 1 voided Company's S election, Company executed Agreement 2 that replaced Agreement 1. Company represents that the termination of Company's S corporation election was inadvertent and not motivated by tax avoidance. Shareholders of Company have consented to make any adjustments as may be required by the Secretary.

The information provided states that on and after Date 1, the owners of Company were all individuals who were eligible S Corporation shareholders, all income and expense items were allocated on a per-share basis, all distributions were made on a pro-rata basis based on ownership, and all shareholders were treated equally in corporate matters.

Company requests relief pursuant to § 1362(f) due to Agreement 1 having governing provisions that created 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 Company's S election terminated on Date 3, as Agreement 1 created more than one class of stock. We further conclude that the termination was inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), Company will be treated as continuing to be an S corporation on and after Date 3, provided that Company's S corporation election was valid and 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.

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.

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,

Richard T. Probst
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: