Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-114801-21

Date:
January 13, 2022

LEGEND

X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

State =

Dear :

This letter responds to a letter dated July 15, 2021, submitted on behalf of X by X's authorized representatives, requesting relief under § 1362(f) of the Internal Revenue Code (the "Code").

FACTS

The information submitted states that X was formed on Date 1 under the laws of State and elected to be treated as an S corporation effective Date 2. X's original Certificate of Incorporation permitted X to issue only one class of stock.

On Date 3, X modified its original Certificate of Incorporation to permit the issuance of a second class of stock. The second class of stock was entitled to certain

distribution and liquidation rights not available to the original class of stock. Specifically, the modified certificate included the following provisions under Schedule A:

(1) Section 5.1 provided, in part, "The total number of shares of stock which the Corporation shall have authority to issue is forty-five thousand (45,000) shares of which (a) forty thousand (40,000) shares are designated as Common Stock ("Common Stock") . . . and (b) five-thousand shares are designated as preferred stock ("Preferred Stock") all of which are designated as Series A Preferred Stock (the "Series A Preferred Stock")."

(2) Section 5.2 provided, in part, "'Junior Stock', means, as to the Series A Preferred Stock, each other class or series of capital stock . . . which ranks junior to the Series A Preferred Stock as to payment of dividends or payment upon a liquidation, dissolution or winding up of the Corporation."

(3) Section 5.4(a) provided, in part, "The holder of each share of Series A Preferred Stock shall be entitled to receive, before any dividends shall be declared and paid upon or set aside for the Junior Stock therefore . . . dividends in cash at the rate per annum per share equal to fifteen percent (15%) of the Original Purchase Price, compounding annually on a cumulative basis."

(4) Section 5.4(b) provided, in part, that liquidating payments to a Series A Preferred Stock holder "is to be paid in full before any payment shall be made to any holders of the applicable Junior Stock thereto."

On Date 3, in conjunction with the creation of the preferred stock class, X entered into an agreement to sell certain units of Preferred Stock to a third-party purchaser. Thus, X's S corporation election terminated on Date 3 as a result of X having more than one class of stock under § 1361(b)(1)(D).

On or about Date 4, X discovered that its S election was ineffective as a result of its prior actions. Upon this discovery, X rescinded and canceled the Preferred Stock by agreement retroactive to Date 3, and further amended its Certificate of Incorporation to only permit the issuance of one class of stock.

X represents that the circumstances surrounding the termination of X's S corporation election were inadvertent and unintended. X further represents that its shareholders have filed consistently with X being an S corporation. In addition, X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) 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 the 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 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, 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, governing provisions).

Section 1.1361-1(l)(3) provides, in part, that, in determining whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds, all outstanding shares of stock of a corporation are taken into account. For example, substantially nonvested stock with respect to which an election under § 83(b) has been made is taken into account in determining whether a corporation has a second class of stock, and such stock is not treated as a second class of stock if the stock confers rights to distribution and liquidation proceeds that are identical, within the meaning of § 1.1361-1(l)(1), to the rights conferred by the other outstanding shares of stock.

Section 1.1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect 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 first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) further provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in relevant part, 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 (B) was terminated under § 1362(d)(2), (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 the discovery of the circumstances resulting in the 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), 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 the representations made, we conclude that X's S corporation election was terminated on Date 3 as a result of X having more than one class of stock. We conclude, however, that the termination described was inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as an S corporation effective Date 3 and thereafter, provided that its S corporation election has not terminated under § 1362(d) other than as discussed in this letter.

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. Specifically, no opinion is expressed or implied concerning whether X otherwise qualifies as an S corporation for federal tax purposes.

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 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 representative.

Sincerely,

By: _/s/_____
Laura C. Fields
Branch Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure (1):
Copy of this letter for § 6110 purposes

cc: