

Internal Revenue Service

Department of the Treasury

Number: **200308035**
Release Date: 2/21/2003
Index Number: 1361.01-04

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:1-PLR-140760-02
Date:
Nov 12 2002

Legend:

X =

State =

Year1 =

Year2 =

Year3 =

Year4 =

Dear _____ :

This letter responds to your representative's letter dated June 28, 2002 requesting a ruling regarding X's status as an S corporation.

FACTS

According to the information submitted, X is a State law corporation, which has elected to be treated as an S corporation. X filed returns as an S corporation for Year1 and previous years. X has a policy of making proportionate distributions in an amount necessary to cover shareholder taxes generated by net flowthrough income. X made distributions for Year1 consistent with this policy. During Year2 and Year3, X redeemed shares held by several of the shareholders. In Year4, X amended its Year1 tax return to include additional income and issued amended K-1s to its shareholders. The shareholders, including the shareholders who redeemed shares, amended their personal returns based on their Year1 holdings and paid the additional amounts due.

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X planned to distribute cash to its shareholders to offset their higher tax liabilities for Year1. Because these tax liabilities depended on the shareholders' pre-redemption interests in X, X and its shareholders agreed that basing the distribution amounts on the shareholders' post-redemption interests would be inequitable. Thus X plans to make a current distribution of cash based on its shareholders' Year1 holdings.

DISCUSSION

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under section 1362(a) is in effect for that year.

Under section 1361(b)(1)(D), a small business corporation cannot have more than one class of stock. Section 1.1361-1(l)(2)(i) of the Income Tax Regulations provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is based on the governing provisions of a corporation. Such provisions include binding agreements relating to distribution and liquidation proceeds.

A corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical rights to operating and liquidating distributions. Under X's bylaws, the shareholders are entitled to equal distributions.

X's planned distributions are remedial in nature and consistent with what would have been distributed for Year1 if the Year1 tax returns had been properly filed.

CONCLUSION

After applying the relevant law and regulations to the representations made, we conclude that the planned distributions for Year4 will not cause the termination of X's S corporation election.

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.

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In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's authorized representative.

Sincerely,

/s/ David R. Haglund

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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