Internal Revenue Service

Number: **202052003**
Release Date: 12/24/2020

Index Numbers: 1361.01-04, 1362.00-00, 1362.02-00, 1362.04-00

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-106295-20

Date:
September 30, 2020

Legend

Company =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Agreement 1 =

Agreement 2 =

Dear :

This letter responds to a letter dated February 18, 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 and elected to be an S corporation effective Date 2. On Date 3, an operating agreement, Agreement 1, was executed and 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. Agreement 1 included the following partnership provisions:

> Section 4.2 providing,
>
> Distribution of Capital Proceeds and Allocation of Profit or Loss from Capital Transactions.
>
> (A) Profit. After giving effect to the regulatory allocations set forth in Section 4.3, Profit from a Capital Transaction shall be allocated as follows: (i) If one or more Interest Holders has a Negative Capital Account, to those Interest Holders, in proportion to their Negative Capital Accounts, until all of those Negative Capital Accounts have been reduced to zero. (ii) Any Profit not allocated pursuant to Section 4.2(A)(i) shall be allocated to the Interest Holders in proportion to, and to the extent of, the amounts distributable to them pursuant to Section 4.2(C)(iv)(a) and (c). (iii) Any Profit in excess of the foregoing allocations shall be allocated to the Interest Holders in proportion to their Percentages.
> (B) Loss. After giving effect to the regulatory allocations set forth in Section 4.3, Loss from a Capital Transaction shall be allocated as follows: (i) If one or more Interest Holders has a Positive Capital Account, to those Interest Holders, in proportion to their Positive Capital Accounts, until all Positive Capital Accounts have been reduced to zero. (ii) Any Loss not allocated to reduce Positive Capital Accounts to zero pursuant to Section 4.2(B)(i) shall be allocated to the Interest Holders in proportion to their Percentages.
> (C) Capital Proceeds. Capital Proceeds shall be distributed and applied by the Company in the following order and priority: (i) To the payment of all expenses of the Company incident to the Capital Transaction; then (ii) To the payment of debts and liabilities of the Company then due and outstanding (including all debts due to any Interest Holder); then (iii) To the establishment of any reserves which the General Manager, if appointed, otherwise the Members, deems necessary for liabilities or obligations of the Company; then (iv) The balance shall be distributed as follows: (a) To the Interest Holders in proportion to their Adjusted Capital Balances, until their remaining Adjusted Capital Balances have been paid in full; (b) If any Interest Holder has a Positive Capital Account after the distributions made pursuant to Section 4.2(C)(iv)(a) and before any further allocation of Profit pursuant to Section 4.2(A)(iii), to those Interest Holders in proportion to their Positive Capital

Accounts; then (c) The balance, to Interest Holders in proportion to their Percentages.

Section 4.4 providing,

Liquidation and Dissolution.

(A) If the Company is liquidated, the assets of the Company shall be distributed to the Interest Holders in accordance with the balances in their respective Capital Accounts, after taking into account the allocations of Profit or Loss pursuant to Sections 4.1 or 4.2, if any, and distributions of cash or property, if any, pursuant to Sections 4.1 and 4.2(C).
(B) An Interest Holder shall be obligated to restore a Negative Capital

Company represents that since Date 2, Company and its shareholders have filed all tax returns consistent with Company having a valid S corporation in effect as of Date 2. Company also represents that since Date 2, all distributions were made to the shareholders based on their pro rata shares of ownership of Company. Company represents that entering into Agreement 1 created a second class of stock, causing its S corporation status to terminate. Company represents that, on Date 4, Agreement 2 replaced Agreement 1, in part, to eliminate the potential for a second class of stock under §1361(b)(1)(D). Company represents that the termination of Company's S corporation election was inadvertent and not motivated by tax avoidance. Company and each person who has been a shareholder of Company at any time on or after Date 1 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 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 the termination of Company's S election as a result of Agreement 1 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 2, and thereafter, provided the S election for Company is otherwise valid on Date 2 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.

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,

_____

Adrienne M. Mikolashek
Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: