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:
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Date:
December 17, 2024

LEGEND:

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

Agreement 1 =

Agreement 2 =

Dear :

This letter responds to a letter dated January 4, 2023, and subsequent correspondence, submitted on behalf of X by its authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that X was formed on Date 1 as a limited liability company under the laws of State. X's owners executed its operating agreement (Agreement 1) effective Date 2. X made an election to be classified as an association taxable as a corporation as well as an election to be classified as an S corporation by filing Form 8832, *Entity Classification Election*, and Form 2553, *Election by a Small Business Corporation*, both effective Date 3.

Agreement 1 did not provide for identical rights to distribution and liquidation proceeds. Specifically, Section 4 of Agreement 1 provided that X's owners may make non-pro rata contributions, and that such contributions would increase the contributing owners' capital accounts. Additionally, Section 5 provided that X could make special allocations to its owners and that X could make distributions that were not in proportion to its owners' proportional ownership interests. Finally, Section 8.4 of Agreement 1 provided that, upon dissolution, X would distribute its remaining assets to its owners in proportion to their positive capital account balances. Taxpayer represents that these provisions of Agreement 1 caused X to have more than one class of stock under § 1361(b)(1)(D), and therefore rendered X's S election effective Date 3 invalid. Separately, X also made disproportionate distributions to certain owners between Date 3 and Date 4.

X represents that on or about Date 4, soon after it learned that the above provisions terminated its S corporation election, it executed an amended operating agreement (Agreement 2). This agreement eliminated the provisions that caused X to have more than one class of stock. X also represents that it has made corrective distributions so that all distributions and allocations of income have been made pro rata.

X requests a ruling that the invalidity of its initial S corporation election effective Date 3 was inadvertent within the meaning of § 1362(f) and that it will be treated as an S corporation beginning on Date 3 and thereafter, provided that its S corporation election did not otherwise terminate. X represents that the circumstances surrounding the invalidity of X's initial S corporation election were inadvertent and not the result of tax avoidance or retroactive tax planning. X further represents that for each taxable year beginning Date 3, X and its shareholders have filed consistently with X being an S corporation. In addition, X and its shareholders agree to make any adjustments that may be required by the Secretary as a condition of obtaining relief under § 1362(f).

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 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 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 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 initial S corporation election effective Date 3 was invalid because of X having more than one class of stock. We conclude, however, that the circumstances that caused this S election to be invalid were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as being an S corporation on and after Date 3, provided that its S corporation election was otherwise valid and has not otherwise terminated under § 1362(d).

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion on whether X was or is otherwise eligible to be an S corporation.

The rulings contained in this letter are 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 that requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representatives.

Sincerely,

Richard T. Probst
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: