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FACTS

X was incorporated under the laws of State on D1, and elected to be an S corporation, effective D2. X's articles of incorporation authorized X to issue Class A and Class B shares. The intent in issuing the Class A and Class B shares was to confer upon the shareholders equal economic rights but differing voting rights. The two classes of stock may have inadvertently conferred differing rights to distribution and liquidation proceeds.

On D3 Shareholder 1 transferred all of the Class A and Class B shares that he owned to Trust. X and Shareholder 1 represent that Trust is a Qualified Subchapter S Trust.

During a review of X's corporate documents on D3, X's special counsel discovered that two classes of stock may have been created under X's articles of incorporation. On D4, X amended its Articles of Incorporation to eliminate the potential two classes of stock.

X represents that it has operated as an S corporation since D1 and that all of its shareholders have reported their shares of X's income, loss, and deductions on their respective tax returns in a manner consistent with that treatment. X also represents that all profits, losses and distributions to Shareholder 1 and Shareholder 2 were made pro-rata based on ownership interests of the stock reflecting ownership of economic rights.

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.

Effective January 1, 1995, Section 1361(b)(1) defined a "small business corporation" as a domestic corporation that is not an ineligible corporation and that 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 that has more than one class of stock does not qualify as a small business corporation. A corporation is 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. Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock. Thus, if all shares of stock of an S corporation have identical rights to distribution and liquidation proceeds,

the corporation may have voting and nonvoting common stock, a class of stock that may vote only on certain issues, irrevocable proxy agreements, or groups of shares that differ with respect to rights to elect members of the board of directors.

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 law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding agreement relating to distribution and liquidation proceeds and thus is not a governing provision unless a principal purpose of the agreement is to circumvent the one class of stock requirement of section 1361(b)(1)(D) and this paragraph (l). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1362(f) provides, in relevant part, that if (1) an election under subsection (a), section 1361(b)(3)(B)(ii), or section 1361(c)(1)(A)(ii) by any corporation (A) was not effective for the taxable year for which made by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of subsection (d), section 1361(b)(3)(C), or section 1361(c)(1)(D)(iii), and (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, and (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) 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 in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the information submitted and the representations made, we conclude that if X had more than one class of stock, X's election to be treated as an S corporation was ineffective. We further conclude that the election was an inadvertent invalid election under § 1362(f). Therefore, X will be treated as an S corporation beginning D2, and thereafter, unless X's S election otherwise terminates under

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§ 1362(d). This ruling is contingent on X and its shareholders treating X as an S corporation for the period beginning D2 and thereafter. X agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period. However, no adjustments will be required because, for the period beginning D2 and thereafter, the shareholders properly included pro rata shares of income, loss, and deductions on their respective tax returns in a manner consistent with X being treated as an S corporation.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X or Trust is otherwise eligible to be treated as an S corporation or a Qualified Subchapter S Trust, respectively.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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,

/s/

Christine Ellison
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)