

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

March 29, 2001

X =

A =

B =

C =

D =

E =

F =

G =

H =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

State =

D1 =

D2 =

D3 =

D4 =

CPA =

Year 1 =

Year 2 =

Dear :

This letter responds to your letter dated August 28, 2000, and subsequent correspondence, submitted on behalf of X, requesting a ruling regarding X's status as an S corporation.

The information submitted states that X is a corporation incorporated under the laws of State on D1. X elected to be an S corporation effective D2. Since D3, A, B, C, D, E, F, G, H, Trust1, Trust2, Trust3, and Trust4, have been or currently are the shareholders of X.

A, as president of X, represents that X's Articles of Incorporation and By-laws provide for a single class of voting common stock with no preferences as to either voting, dividends, or distributions among the shares of stock. A represents there was no written or oral agreement or understanding that any shareholder of X would be entitled to any preference with respect to the distributions made by X.

In reliance on advice from CPA, from Year 1 to Year 2, X made disproportionate distributions primarily to A.

X represents that, despite the disproportionate distributions, from Year 1 through Year 2, the shareholders of X each reported the shareholder's pro rata share of the items of income and expense of X based upon the shareholder's pro rata

ownership of X's stock.

On D4, B's spouse became aware of the disproportionate distributions to A and raised the issue with CPA. Although CPA stated that the distributions were appropriate, upon further examination, the shareholders of X determined that the disproportionate distributions may have caused a termination of X's S election. At that time, steps were taken to equalize the distributions. Moreover, X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

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 § 1362(a) is in effect for that year.

Section 1361(b)(1)(D) provides that a small business corporation cannot have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation generally 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.

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. 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.

Based solely on the representations made and the information submitted, we conclude that because X's stock has identical distribution rights under its governing provisions, the difference in timing between X's disproportionate distributions to A and the remedial distributions to the other shareholders does not cause X to have more than one class of stock for purposes of § 1361(b)(1)(D). However, such disproportionate and remedial distributions must be given appropriate tax effect. Under these circumstances, we conclude that X's S election did not terminate because of the disproportionate distributions to A and the remedial distributions to the other shareholders.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described under any other provision of the Code, including whether X is otherwise eligible to be an S corporation. This ruling letter 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.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X and to X's other representative.

Sincerely yours,

JEANNE M. SULLIVAN
Assistant to the Chief
Branch 2
Office of the Associate
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of this letter
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