

Internal Revenue Service

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Person To Contact:

Telephone Number:

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Legend

X =

State =

A =

B =

C =

D1 =

D2 =

D3 =

D4 =

D5 =

y% =

z% =

Dear

This letter responds to a letter dated November 19, 2004, submitted on behalf of X by X's authorized representative, 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 in D1. X elected to be an S corporation effective D2. X's shareholders were A, B and C. At that time, and at all times thereafter, A owned y% and B and C each owned z%.

X represents that it only has a single class of outstanding stock since D1 and as a matter of State law all of X's outstanding shares have identical rights to distribution and liquidation proceeds. Neither X's Articles of Incorporation nor By-laws changes these rights. Furthermore, X represents that there is not an agreement (written or oral) or understanding that any shareholder would be entitled to a preference regarding X's distribution and liquidation proceeds.

Although X's chief financial officer (CFO) properly made actual distributions from D3 through D4 in accordance with the ownership interests of A, B and C, the CFO also caused X to make payments directly to government entities on behalf of A, B and C for their tax liabilities. These distributions were not in proportion to the ownership interests of A, B and C. The CFO was not aware that such payments would create disproportionate distributions that could terminate X's S election.

On D5, shortly after learning about the potential termination of X's S election, X made corrective distributions to A and C. Furthermore, X, A, B and C 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) of the Internal Revenue Code 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 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, B and C, and the remedial distributions to A and C do 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, B and C, and the remedial distributions to A and C.

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's authorized representative.

Sincerely yours,

J. Thomas Hines
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

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