

S Corporations & Blank Check Preferred Stock

By [Jordan Taylor](#), CPA and Joe Wallin

I have heard this a number of times:

"A corporation cannot make an S election if it has preferred stock authorized in its charter, even if the preferred stock is 'blank check,' meaning it doesn't have any rights, preferences and privileges ascribed to it, and none of it has been issued."

"Blank check" preferred is just preferred stock that is set aside and reserved for in the charter--but without any rights yet ascribed to it. People who form a new corporation often include blank check preferred in the charter.

For example, a corporation might have ten million (10,000,000) authorized shares, but those might be broken into nine million (9,000,000) common and one million (1,000,000) preferred. The preferred will be blank check. Again, this means that no rights have been ascribed to the preferred. No liquidation preference per share. No voting rights. Nothing.

Blank check preferred just sits there until the Board decides to ascribe the rights, preferences and privileges and actually issue the shares.

The Internal Revenue Code says that an S corporation cannot "have more than 1 class of stock."

But what counts as "stock" for this purpose?

Here is a excerpt [from an IRS publication on this point](#):

Unissued stock. Authorized but unissued stock and treasury stock are not considered in determining if a corporation has more than one class of stock...The existence of outstanding options, warrants to acquire stock, or convertible debentures will not, by itself, be considered a second class of stock.

There is also [this from the regulations](#):

(3) Stock taken into account. Except as provided in paragraphs (b) (3), (4), and (5) of this section (relating to restricted stock, deferred compensation plans, and straight debt), in determining whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds, all outstanding shares of stock of a corporation are taken into account. For example, substantially nonvested stock with respect to which an election under section 83(b) has been made is taken into account in determining whether a

corporation has a second class of stock, and such stock is not treated as a second class of stock if the stock confers rights to distribution and liquidation proceeds that are identical, within the meaning of paragraph (l)(1) of this section, to the rights conferred by the other outstanding shares of stock.

There is also this, from [***an article written by Boris I. Bittker and James S. Eustice:***](#)

"One class of stock. The corporation may not have more than one class of stock. The regulations state that a class of stock is to be counted for this purpose only if it is issued and outstanding, so that treasury stock or authorized but unissued stock of a second class will not disqualify the corporation."

In summary, merely having "blank check" preferred stock authorized in your charter does not blow your S election.