

Internal Revenue Service

Department of the Treasury

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Legend:

X =

State =

State Act =

CY =

n1 =

n2 =

n3 =

n4 =

A =

B =

C =

p1 =

p2 =

D1 =

D2 =

D3 =

D4 =

This responds to a letter dated December 22, 1999, submitted on behalf of X requesting a ruling that as of D1, the C Family members and related C Family trusts were no longer X shareholders within the meaning of Section 1362(a)(2), and, therefore, their consent to X's S corporation election, effective D2, is not required.

FACTS

X is a State corporation engaged in the business of, among other things, manufacturing ceiling grids and coil-coating steel. X is the parent of a consolidated group of companies involved in similar activities.

X has n1 shares of common stock issued and outstanding, all held by three brothers, A (the "A Family"), B (the "B Family"), and C (the "C Family"), and their respective families. The A Family owns n2 shares, or p1% of total shares. The B Family owns n2 shares, or p1% of total shares. The C Family owns n3 shares, or p2% of total shares.

On D3, the C Family filed and Amended Complaint for Corporate Dissolution (the "Complaint") in the Circuit Court (the "Court") of CY, State against X, the A Family, and the B Family. The Complaint was filed pursuant to the State Act. The Complaint asked the Court to order the dissolution of X or to mandate a buy-out of the C family's X stock.

On D1, X filed an Election to Purchase shares with the Court, pursuant to the State Act. Once X elected to buy out the C Family's shares, the State Act prohibits the C Family from selling or otherwise disposing of their X shares. Similarly, X's election is irrevocable. Pursuant to a letter agreement between attorneys for X and the C Family, X placed n4 dollars in a segregated investment account to enable X to purchase the C Family's shares without borrowing funds.

The State Act contemplates that an Election to Purchase Shares will include the issuer's proposed purchase price. If the parties are unable to reach an agreement on the purchase price for the shares, the State Act provides that the court shall stay the proceeding and determine the fair market value of the petitioner's shares.

Because X, the A Family, B Family, and C Family could not reach an agreement on the purchase price of the C Family shares, the Court has appointed an appraiser to develop a valuation of the C Family's shares. The valuation process for the C Family shares will extend beyond D4, the last day to make an S corporation election effective for D2.

In *Ragghianti v. Commissioner*, 71 T.C. 346 (1978), acq., 1979-2 C.B. 2, the court concluded that, in deciding who is the shareholder of subchapter S stock, beneficial ownership of the stock in the controlling test.

The Tax Court in *Ragghianti* held that an individual who was required to sell his shares of stock in an S corporation pending an appraisal was merely holding record title to his shares in escrow for the purchaser, and was not a shareholder under the S corporation provisions of the Code.

X is currently a C corporation, X has recently decided that it is in the best interest of X and its remaining shareholders to make an S corporation election, pursuant to Section 1362, effective as of D2.

LAW AND ANALYSIS

Section 1361(a)(1) defines an “S corporation”, with respect to any taxable year, as a “small business corporation” for which an election under Section 1362(a) is in effect for such year.

Section 1362(a)(2) provides that an S corporation election shall be valid only if all persons who are shareholders in such corporation on the day on which the election is made consent to such election.

Section 1362(b)(1) provides that an S corporation election may be made for any taxable year at any time during the preceding taxable year, or at any time during the taxable year and on or before the fifteenth day of the third month of the taxable year.

Section 1362(b)(2)(B)(ii) provides that if an election is made within two months and fifteen days of the tax year for which the election is to be effective, then any person who was a shareholder during that tax year must consent to the election; otherwise the election will be treated as made for the following taxable year.

CONCLUSION

Based solely on the facts submitted and representations made, and provided that X otherwise qualifies as a subchapter S corporation, we conclude that for purposes of subchapter S, the C Family members and related C Family trusts are no longer X shareholders within the meaning of Section 1362(a)(2), and, therefore, their consent to X’s S corporation election, effective D2, is not required.

Except as specifically set forth above, no opinion is expressed or implied as to the federal income tax consequences of the transaction described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X is, in fact, an S corporation for federal tax purposes.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code 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,
Dianna K. Miosi
Chief, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

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