

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B01-PLR-142244-01

Date:

September 21, 2001

Legend:

X =

Date 1 =

Date 2 =

Date 3 =

State =

This letter responds to your request, dated June 8, 2001, for a written determination requesting relief under section 1362(f) of the Internal Revenue Code from X's inadvertent invalid S election.

Facts

According to the information submitted and representations therein, X was incorporated on Date 1 under the laws of State. Upon incorporation, both preferred and common stock were issued to the shareholders. X operated as a C corporation for tax purposes from Date 1 until it elected to be treated as a S corporation, effective Date 3. Until Date 2, one shareholder owned substantially all of the common and preferred outstanding stock of X. In Date 2, the current sole shareholder purchased all of the outstanding stock of X. Since Date 2, X has had the same sole shareholder.

Prior to contacting the taxpayer's representative on another unrelated matter with regard to X, the sole shareholder was unaware of the existence of the second class of preferred stock in X and of its effect on X's S election. The taxpayer's representative advised that a complete audit of X's corporate records would be required in order to determine whether or not there were two classes of stock in existence. A subsequent review of the corporate records indicated that the current sole shareholder purchased all of the outstanding common and preferred stock of X in Date 2.

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X's sole shareholder sought to remedy the situation by contributing all preferred stock to X. The contributed preferred stock was then canceled, leaving only the one class of common stock in existence. X has filed tax returns consistent with a S corporation since the S election effective date of Date 3. Furthermore, no preferred stock dividends were issued since the sole shareholder acquired the stock in Date 2.

Law and Analysis

Section 1361(a)(1) defines an S corporation as a small business corporation for which an election under section 1362(a) is in effect. Section 1361(b)(1) defines "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, other than a trust described in section 1361(c)(2) and other than an organization described in (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, subject to certain exceptions, 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 are disregarded in determining whether a corporation has more than one class of stock.

Section 1362(f), in relevant part, provides that if (1) an election made under section 1362(a) by any corporation was not effective for the tax year for which made by reason of a failure to meet the requirements of section 1361(b), (2) the Secretary determines that the the circumstances resulting in the ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness, steps were taken so that the corporation is a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to section 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the terminating event, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Conclusion

Based upon the information submitted and the representations set forth above, we conclude that the termination of X's S corporation election was inadvertently invalid within the meaning of section 1362(f).

Pursuant to the provisions of section 1362(f), X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided that X's subchapter S election is not otherwise invalid and provided that the election was not terminated under section 1362(d).

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Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code. In particular, no opinion is expressed or implied concerning whether X's election was valid under section 1362.

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.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,
David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for section 6110 purposes