Internal Revenue Service

Number: **200227035**
Release Date: 7/5/2002
Index Number: 1362.04-00

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-100605-02
Date:
April 8, 2002

LEGEND

Taxpayer =

Shareholders =

Preferred Shareholders =

Acquirer =

Counsel =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear

This letter responds to a letter dated December 28, 2001, and subsequent correspondence, requesting a ruling under § 1362 of the Internal Revenue Code. In particular, the letter requests a ruling that the termination of Taxpayer's S corporation election was an inadvertent termination within the meaning of § 1362(f).

Facts

Taxpayer began doing business on Date 1 and elected to be taxed an S corporation effective Date 1.

On Date 2, Taxpayer issued a class of preferred stock. Taxpayer represents that it was not aware that issuance of preferred stock would terminate Taxpayer's S election and that Taxpayer was not advised of this consequence by the attorneys consulted.

Between Date 3 and Date 4, Acquirer investigated a possible acquisition of Taxpayer. During this time, Acquirer hired Counsel to perform due diligence. Counsel informed Acquirer that Taxpayer's S corporation likely terminated as a result of the issuance of preferred stock to Preferred Shareholders. On Date 4, remedial steps were taken to convert all outstanding shares of preferred stock into that of common stock and Taxpayer decided to seek relief under § 1362(f) for inadvertent termination of its S election.

Taxpayer represents that it and its shareholders have always reported the income, loss, deductions, and credits of Taxpayer consistent with Taxpayer's S status and each shareholder has reported the shareholder's pro rata share of Taxpayer's income, loss, deduction, and credit. Moreover, Taxpayer represents that there have been no distributions to Shareholders or Preferred Shareholders during the period the preferred stock was outstanding and that income was allocated to the preferred and common shares as if the preferred shares were common shares.

Furthermore, Taxpayer, Shareholders, and Preferred Shareholders have consented to make all adjustments consistent with the treatment of Taxpayer as an S corporation with respect to the period of termination.

Applicable Law

Section 1361(a)(1) generally provides that an "S corporation" is a small business corporation for which an election under § 1362(a) is in effect.

Section 1361(b) provides the definition of a "small business corporation" for purposes of subchapter S. Section 1361(b)(1)(D) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have more than 1 class of stock.

Section 1362(d)(2) generally provides that an election to be treated as an S corporation terminates whenever such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that such termination is effective on and after the date the S corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that, if (1) an election under § 1362(a) by any corporation was terminated under subsection (d)(2), (2) the Secretary

determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, 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 agrees to make such 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 circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based on the facts submitted and the representations made, we conclude that Taxpayer's S corporation election terminated on Date 2, when Taxpayer issued a second class of stock. We also conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to § 1362(f), Taxpayer will be treated as continuing to be an S corporation from Date 2 until Date 4, provided that Taxpayer's S election was not otherwise terminated under § 1362(d) and the items of income, loss, deduction, and credit of the S corporation are allocated to Shareholders and Preferred

Shareholders pro rata as though there was only one class of stock in Taxpayer and make any other adjustments required.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Internal Revenue Code. Specifically, we express or imply no opinion concerning whether Taxpayer is otherwise qualified to be an S corporation.

This ruling 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.

Sincerely yours,
Jeanne M. Sullivan
Senior Technician Reviewer
Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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