

Internal Revenue Service

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LEGEND

X =

A =

B =

State =

D1 =

Ya =

Yb =

Yc =

c% =

d% =

e% =

f% =

Dear _____ :

This letter responds to a letter dated June 25, 2007, and subsequent correspondence written on behalf of X, requesting a ruling under § 1362(b)(5) and (f) of the Internal Revenue Code.

FACTS

X was formed under State law on D1. At the time of its formation, X's shareholders, A and B intended for X to be an S corporation effective D1. However, X's Form 2553, Election by a Small Business Corporation, was not filed timely.

From D1 through Yb, A owned c% of X, and B owned d%. For years after Yb, A owned e% of X, and B owned f%. X represents that X may have made disproportionate distributions to A and B during the period from D1 through Yc. However, X represents that if any disproportionate distributions have been made, X has taken steps to correct those disproportionate distributions.

X requests a ruling that it will be recognized as an S corporation effective D1. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

LAW AND ANALYSIS

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

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

Section 1362(b)(1) provides that an election under § 1362(a) may be made by a small business corporation for any taxable year (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before the 15th day of the third month of the taxable year. Section 1362(b)(3) provides that if a small business corporation makes an election under § 1362(a) for any taxable year, and the election is made after the 15th day of the third month of the taxable year and on or before the 15th day of the third month of the following taxable year, then the election is treated as made for the following taxable year.

Section 1362(b)(5) provides that if an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)), after the date prescribed by § 1362(b) for making the election for the taxable year, or no § 1362(a) election is made

for any taxable year, and the Secretary determines that there was reasonable cause for the failure to timely make the election, then the Secretary may treat the election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever the corporation ceases to be a small business corporation.

For S corporation elections made and terminations occurring before January 1, 2005, § 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(l)(1) provides in part that a corporation that has more than one class of stock does not qualify as a small business corporation. Generally, 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.

Section 1.1361-1(l)(2) provides in part 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 (collectively, the governing provisions). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding agreement relating to distribution and liquidation proceeds and thus is not a governing provision unless a principal purpose of the agreement is to circumvent the one class of stock requirement of section 1361(b)(1)(D) and this paragraph (l). 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.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based on the facts and representations submitted, we conclude that X had reasonable cause for its failure to make an election under § 1362(a). Therefore the election is to be treated under § 1362(b)(5) as filed timely effective D1.

We further conclude that if X's S corporation election may have terminated due to a second class of stock, the termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation from D1 and thereafter, provided X's S corporation election is otherwise valid and is not otherwise terminated under § 1362(d), and X and shareholders A and B make the following adjustments: X must file Form 1120S (U.S. Income Tax Return for an S Corporation) for its tax years Ya through Yb. For all relevant years, A and B must include the separately and nonseparately computed items attributable to their shares in their income as provided in § 1366, make adjustments to the stock basis of those shares as provided in § 1367, and take into account any distributions with respect to those shares as provided in § 1368. In addition, X must file Form 2553, to be effective on D1, with the appropriate service center no later than 60 days from the date of this letter. A copy of this letter should be attached to the Form 2553. A copy is enclosed for that purpose.

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation for federal tax purposes.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

/s/

Christine Ellison
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes