Internal Revenue Service

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Department of the Treasury

199952076

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
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Date:

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Legend

Company =

D1 =

D2 =

D3 =

D4 =

State =

Shareholders =

469

Dear

This letter responds to the letter submitted on Company's behalf dated March 16, 1999, as supplemented, requesting a ruling under § 1362(f) of the Internal Revenue Code that Company's S corporation election was inadvertently invalid.

FACTS

The following facts have been represented. Company was incorporated on D1 under the laws of State. As of D2, Company had a variety of classes of common and preferred stock outstanding. Company elected to be classified as an S corporation effective D3. In order to satisfy the single class of stock requirement of § 1361(b)(1)(D), Company redeemed all outstanding shares of preferred stock prior to D3. However, as of D3, not all outstanding classes of common stock had identical liquidation and distribution rights. When Company became aware of the significance of the distinctions, Company began proceedings to redeem one of the outstanding classes of common stock. The redemption was effective on D4. After the redemption, all outstanding shares of stock in Company had identical liquidation and distribution rights. During the period from D3 to D4, Company did not make any distributions with respect to its stock. Company and its Shareholders agree to make any adjustments necessary (consistent with the treatment of Company as an S corporation) as may be required.

LAW AND ANALYSIS

Section 1361(a)(1) provides that, for purposes of the Code, the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under § 1362(a) is in effect for the year.

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 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) provides, in part, that if (1) an election under 1362(a) by any corporation was not effective for the taxable year for which made by reason of a failure to meet the requirements of section 1361(b), (2) the Secretary determines that 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, agrees to make 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 the ineffectiveness, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we hold that Company's S corporation election was inadvertently invalid within the meaning of § 1362(f). Consequently we rule that Company will be treated as an S corporation beginning D3, and thereafter, unless Company's S election otherwise terminates under § 1362(d).

This ruling is contingent on Company and all Shareholders treating Company as having been an S corporation for the period beginning D3, and thereafter. Accordingly, all Shareholders, in determining their respective income tax liabilities for the period beginning D3, and thereafter, must include their pro rata share of the separately and nonseparately computed items of Company as provided in § 1366, make adjustments to stock basis as provided in § 1367, and take into account any distributions made by Company as provided by § 1368.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding the effects of any redemption. Further, no opinion is expressed regarding whether Company is otherwise eligible to be an S corporation.

In accordance with the power of attorney on file with this office, copies of this letter are being sent to your authorized representatives.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

William P. O'Shea
Branch Chief
Branch 3
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
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