Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:1-PLR-150292-02
Date:
January 10, 2003

Legend:

X =

State =

D1 =

D2 =

D3 =

D4 =

Dear :

This responds to a letter dated September 4, 2002, submitted on behalf of X, requesting a ruling that X's election to be treated as an S corporation was an inadvertent invalid election under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws State on D1. X elected subchapter S status, effective, D2. On D2, X corporation had outstanding four classes of stock. At that time, X's articles of incorporation provided for dividend and liquidation preferences for the holders of certain stock. X subsequently retained new legal counsel. Upon review of X's records, X's legal counsel discovered that X may have issued more than one class of stock. Effective D3, the outstanding shares of three of the classes of stock were exchanged for the fourth class of stock.

Also on D3, X's articles of incorporation were amended to eliminate all but the fourth class of stock. On D4, the amended articles of incorporation were filed in the offices of State.

X represents that from D1 through D4, X and the shareholder of X filed their returns as if X were a valid S corporation, and at all times since D1, distributions of corporate profits were made without regard to any preferences provided under X's articles of incorporation, and X paid no liquidation preferences with respect to any of its stock. Further, X represents that the issuance of more than one class of stock was not motivated by tax avoidance.

LAW AND ANALYSIS

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

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

Section 1361(b)(1) defines a "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 the general rule that a corporation that has more than one class of stock does not qualify as a small business corporation. Except as provided in paragraph 1.1361-1(l)(4), 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 of a corporation are disregarded in determining whether a corporation has more than one class of stock.

Section 1.1361-1(l)(2) provides that, in general, 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).

The Committee reports accompanying the Subchapter S Revision Act of 1982 explain § 1362(f) as follows:

> If the Internal Revenue Service determines that a corporation's subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and the shareholders agree to be treated as if the election had been in effect for such period.
>
> The committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequence of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that the taxpayers and the government will work out agreements that protect the revenues without undue hardship to taxpayers . . . . It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24; H.R. Rep. No. 826, 97th Cong., 2d Sess. 12 (1982), 1982-2 C.B. 730, 735.

CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that X's election to be treated as an S corporation was not effective on D2, because X failed to qualify as a small business corporation, and further, that the circumstances resulting in such ineffectiveness were inadvertent. Therefore, pursuant to § 1362(f), X will be treated as an S corporation from D2, and thereafter, provided that X's subchapter S election is not otherwise terminated under § 1362(d).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 the Power of Attorney on file with this office, a copy of this letter is being sent to X.

Sincerely,

/s/ Dianna K. Miosi

Dianna K. Miosi
Chief, Branch 1
Office of Office of Associate Chief Counsel
(Passthroughs and Special Industries)

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