Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

In Re:

Refer Reply To:
CC:PSI:B03 – PLR-139040-03
Date:
November 13, 2003

LEGEND

Company =

Shareholders =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Corporation =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

m =

n =

Dear :

This letter responds to a letter dated April 24, 2003, and subsequent correspondence, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

Facts

Company incorporated on Date 1 under the laws of State. Company elected to be an S corporation effective Date 1.

On Date 2, Company issued m shares of preferred stock to Shareholder 1, and n shares of preferred stock to Shareholder 2. On Date 3, Company issued m shares of preferred stock to Shareholder 3. Subsequently, on Date 4, Company issued n shares of preferred stock to Corporation.

On Date 5, Company's tax professional learned of the issuance of a second class of stock, and on Date 6 learned of the issuance of a second class of stock to an ineligible shareholder. Company's tax professional advised immediate corrective action. On Date 7, Company redeemed the shares of preferred stock held by Shareholder 1, Shareholder 2, Corporation, and Shareholder 3. Company then issued common stock to Shareholder 1, Shareholder 2, Corporation, and Shareholder 3. On Date 8, Corporation transferred its common stock to Shareholder 4, an eligible shareholder.

Company represents that Company was unaware that an S corporation could have no more than one class of stock and that Corporation was an ineligible shareholder. Additionally, Company and its shareholders represent that there was no intent to terminate Company's S election and that there was no intent to engage in tax avoidance or retroactive tax planning. Company and its shareholders agree to make any adjustments, consistent with the treatment of Company as an S corporation, that the Secretary may require with respect to the period of termination.

Applicable Law

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1361(a)(1) generally 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)(B) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(b)(1)(D) provides that a small business corporation may not have more than 1 class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) is terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) 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 that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (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 the termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, 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 such period, then, notwithstanding the circumstances resulting in the termination, such corporation is 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 the issuance of a second class of stock and issuance of stock to an ineligible shareholder terminated Company's S corporation election. We also conclude that the

termination of Company's S election was inadvertent within the meaning of § 1362(f). Therefore, Company will be treated as continuing to be an S corporation from Date 2 and thereafter provided Company's S corporation election was not otherwise terminated under § 1362(d).

This ruling is contingent on Company and all of its shareholders treating Company as an S corporation for the period beginning Date 2 and thereafter. Accordingly, Shareholders, in determining their federal tax liability, must include their pro rata shares of the separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company under § 1368. If Company or Shareholders fail to treat Company as described above, this ruling shall be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed on whether Company is otherwise qualified to be an S corporation under § 1362.

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,

/s/

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

Enclosures (2):
Copy of this letter
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cc: