

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:2-PLR-131504-00  
Date:  
March 26, 2001

Legend

X:

A:

B:

C:

D:

E:

Lawyer:

State Corporation Bureau:

D1:

D2:

D3:

D4:

Year 1:

PLR-131504-00

Year 2:

Dear \_\_\_\_\_ :

This letter responds to your representative's letter dated \_\_\_\_\_, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The represented facts are as follows: X is a corporation that filed an election to be treated as an S corporation under § 1362 for its taxable year beginning D1, Year 1. On D1, Year 1, A, B, C, D and E were the shareholders of X. At the time the S corporation election was filed for X, X's corporate charter contained dividend and liquidation preferences for the holders of certain stock.

From Year 1 through Year 2, X and the shareholders of X filed their returns as if X were a valid S corporation, and at all times since D1, Year 1, distributions of corporate profits have been made without regard to any preferences provided under X's corporate charter and X has paid no liquidation preferences with respect to any of its stock. When X hired Lawyer to prepare a new shareholder agreement, Lawyer discovered the preferences for certain stock after he obtained copies of X's corporate charter from State Corporation Bureau on or about D2. Lawyer informed X and X's current accountant of the dividend and liquidation preferences with respect to certain stock and recommended that X and the shareholders of X amend the corporate charter to eliminate all but the voting difference in X's stock. On D3, the shareholders signed amended documents eliminating all but the voting difference in X's stock. The amended corporate charter was filed with State Corporation Bureau on D4.

X and the all of those who have been shareholders of X between D1, Year 1, and the present have agreed to make any adjustments that the Commissioner may require consistent with treatment of X as an S corporation.

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 which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2)) who is not an individual, (C) have a

PLR-131504-00

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).

Section 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 (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such 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 in the corporation at any time during the period specified pursuant to § 1362(f), 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 such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

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 D1, Year 1, because of X's failure 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 D1, Year 1, and thereafter, provided that X's subchapter S election is not otherwise terminated under § 1362(d). Accordingly, X's shareholders, in determining their federal tax liability, must include their pro rata share of the separately and nonseparately computed items of X under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by X to shareholders under § 1368. This ruling shall be null and void if the requirements of this paragraph are not met.

PLR-131504-00

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the above-described facts under any other provision of the Code. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely yours,  
Jeanne M. Sullivan  
Assistant to the Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2

Copy of this letter

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