Internal Revenue Service

Number: **200538001**
Release Date: 9/23/2005
Index Number: 1361.03-02, 1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:2
PLR-104804-05
Date:
May 27, 2005

Legend

X = EIN:

A = SSN:

B = SSN:

State =

Date 1 =

Date 2 =

Year 1 =

Year 2 =

Year 3 =

a =

b =

Dear :

This is in reply to a letter, dated January 12, 2005, and subsequent correspondence submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State in Year 1. X's two shareholders are A and B. X filed a Form 2553, Election by a Small Business Corporation, effective Date 2. However, in Year 3, X's accountant realized that X had a shares of preferred stock outstanding and b shares of common stock outstanding. The common and preferred shares had identical dividend and distribution rights. But, on liquidation, the preferred stock had distribution rights in priority over the common stock. Further, the preferred stock and common stock had disparate voting rights. X did not therefore qualify to be an S corporation, because it had two classes of stock. On Date 2, in order to correct the error, X repurchased and retired the preferred stock.

A, X's president, represents the circumstances resulting in the ineffectiveness of X's election to be an S corporation were inadvertent and that X's shareholders did not intend to engage in tax avoidance or retroactive tax planning. Further, X and its shareholders have treated X as an S corporation for all taxable years beginning in Year 2. X and X's shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require.

Section 1361(a)(1) of the Code provides that an "S corporation" means a small business corporation for which an election under § 1362(a) is in effect for such taxable 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 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation 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, (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, 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 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, the 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 S election was ineffective for the taxable year beginning on Date 2, because X had two classes of stock. We further conclude that the ineffective election was inadvertent within the meaning of § 1362(f). Accordingly, under the provisions of § 1362(f), X will be treated as an S corporation from Date 2, and thereafter, provided that X's S election was not otherwise invalid, or has not otherwise been terminated under § 1362(d).

This ruling is contingent on X and all of its shareholders treating X as having been an S corporation for the period beginning Date 2 and thereafter. Accordingly, all of the shareholders in X, in determining their respective income tax liabilities for the period beginning Date 2 and thereafter must include their pro rata share of the separately stated and non-separately computed items of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

Except as specifically ruled upon above, we express no opinion concerning the Federal tax consequences of the transactions described above under any other provisions 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 the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer's representative.

Sincerely,

J. Thomas Hines
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

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