Internal Revenue Service

Number: **200826003**
Release Date: 6/27/2008

Index Number: 1362.04-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-108076-08

Date: March 21, 2008

X =

Y =

State =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

Dear :

This letter responds to a letter dated February 1, 2008, on behalf of X from X's authorized representative, requesting inadvertent termination relief under §1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State on D1. X acquired Y in D2 and has owned all of the stock of Y at all times since D3. X timely filed a Form 2553, Election by a Small Business Corporation, effective D3, and X timely filed Form 8869 to elect qualified subchapter S subsidiary (QSub) status for Y effective D3.

On D4, X's shareholders adopted resolutions approving the creation of a class of nonvoting stock to be issued through a stock dividend, and amended X's articles of incorporation to increase the number of authorized shares. On D5, X issued additional shares of nonvoting stock through a stock dividend. However, the person who was responsible for filing the amended articles of incorporation with the State did not file the amendment as required by State law. This amendment was later filed on D6. Accordingly, it is not clear what rights would be conferred upon the holders of the issued but unauthorized stock under State law during the period between D3 and D6.

From D3, onward, X represents that it filed its tax returns as if it were an S corporation, including the results of Y's operations in the returns. This includes allocating its items of income, loss, deduction, and credit to all of its shareholders proportionately to each share of X's issued common stock regardless of whether a share was authorized or unauthorized. X also represents that the amount of tax paid during this period was the same as if its shareholders had held the stock in X regardless of whether a share was authorized or unauthorized. In addition, X and its shareholders represent that, assuming X's issuance of unauthorized shares of its common stock caused a second class of stock in X, the termination of X's S corporation election and QSub election was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation that the Secretary may require.

X requests a ruling that the termination of its S corporation election and QSub election was inadvertent within the meaning of §1362(f), the termination of the S corporation election and QSub election is waived, X will be recognized as an S corporation continuously from D3, and Y will be recognized as a QSub continuously from D3.

LAW AND ANALYSIS

Section 1361(a) 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)(3)(B) defines a QSub as any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)), if (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a QSub.

Section 1361(b)(1)(D) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not, among other requirements, have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that 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) of the Regulations provides that 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.

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

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st 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 any termination under section 1362(d)(2)(A) shall be effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under §1362(a) or § 1361(b)(3)(B)(ii) by any corporation was terminated under § 1362(d)(2), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation or a QSub, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to §1362(f), agrees to make adjustments (consistent with the treatment of the corporation as an S corporation or a QSub) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation or a QSub during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that, if any rights conferred by State law upon the issued but unauthorized stock of X differ in

liquidation or distribution rights from the issued and authorized stock, this would have resulted in a termination of X's S corporation status on D5, due to the presence of a second class of stock, and would have resulted in a termination of X's election to treat Y as a QSub. We also conclude that such a termination of X's S corporation election and Y's QSub election would have been "inadvertent" terminations within the meaning of § 1362(f).

Under the provisions of §1362(f), X will be treated as an S corporation and Y will be treated as a QSub from D3, and thereafter, provided that, apart from the inadvertent termination ruling above, X's S corporation election was otherwise valid and has not otherwise terminated under §1362(d). Accordingly, from D3, the shareholders of X must include their pro rata share of the separately stated and non-separately stated computed items of X as provided in §1366, make any adjustments to basis as provided in §1367, and take into account any distributions made by X as provided in §1368. If X and its shareholders fail to treat X as described above, this ruling will be null and void.

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

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

Sincerely,

/s/

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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