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Department of the Treasury
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Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-112574-10

Date:
August 05, 2010

X =

Y =

State =

A =

B =

C =

D =

E =

F =

Date 1 =

Date 2 =

Date =

3
Date =
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n1 =

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Dear :

This responds to a letter dated March 19, 2010, and subsequent correspondence, submitted on behalf of X by its 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 on Date 1 and elected to be an S corporation effective Date 2. At the time of incorporation, X's sole shareholder was A and X's articles of incorporation provided for the issuance of one class of stock. In Date 3, X's articles of incorporation were amended to allow for two classes of stock. Except for voting rights, all other characteristics, rights, and obligations of the two classes of stock were identical. Subsequently, B, C, D, E, and F each acquired stock in X.

Each year, X declared a dividend at the end of each year in an amount equal to X's estimated taxable income for such year. Such dividends were pro-rata based upon the shareholders' proportionate ownership interest in X. However, in the years during which X's cash flow was inadequate to cover the amount of the declared dividend, X treated the amount of the shortfall as a deemed distribution to its shareholders, followed by a loan from such shareholders back to X (the Shareholder Loans). For Shareholder Loans made in Year 1 and Year 2, X intended to pay n1% interest on Shareholder Loans from C, D, E, and F and n2% interest on Shareholder Loans from A and B. For Shareholder Loans made in Year 3 and thereafter, X intended to pay n3% interest on Shareholder Loans from C, D, E, and F (except that Shareholder Loans from C beginning in Year 4 accrued at a n2% interest rate) and n2% interest on Shareholder Loans from A and B.

Prior to Year 6, all Shareholder loans from C, D, E, and F were repaid during the year while Shareholder Loans from A and B (and for Year 5, from C) were often carried forward from year to year. During Year 6 and Year 7, Shareholder Loans generally remained outstanding for more than one year.

During Year 5, X loaned funds to B (the B Loans), and B paid simple interest at n2% on the B Loans. B made a significant payment on the B Loans by offsetting the dividend otherwise due to B for Year 5, and the B Loans were fully satisfied by offsetting the dividend due to B for Year 6.

In Date 4, X became aware that the Shareholder Loans or the B Loans may have created a second class of stock, thereby terminating X's S election. On Date 5, X took corrective action by paying the appropriate shareholders the difference between n2% and the interest that had been actually paid on the Shareholder Loans for the period from Year 3 to the present. Upon further review, X discovered that additional interest for Year 1 and Year 2 remains payable. X has yet to complete the necessary corrective adjustments with respect to Year 1 and Year 2, but represents that X will do so. On Date 5, Y purchased all of the shares in X.

X represents that the circumstances resulting in the possible termination of X's S corporation election were inadvertent and not motivated by tax avoidance. X further represents that from Date 2, X and its shareholders have filed all returns consistent with X's status as an S corporation. X and its shareholders have agreed to make such adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

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 § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the

ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the 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 the ineffectiveness or termination, the corporation will 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 corporation election may have terminated in Year 1 because X may have had more than one class of stock. However, we conclude that, if X's S election was terminated, such a termination was inadvertent within the meaning of § 1362(f). In addition, we conclude that to the extent that X's S corporation may have terminated as a result of any of the other events described above, had it not already terminated in Year 1, such termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Year 1 and thereafter, provided X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d) for the reasons not addressed in this letter. This ruling is contingent upon X paying the remaining additional interest, which X represents is still owed, for Year 1 and Year 2 to its shareholders within 120 days of this letter.

Except as specifically set forth above, we express 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) 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, we are sending a copy of this letter to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

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