

Internal Revenue Service

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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:B01
PLR-146643-04
Date:
October 01, 2004

In Re:

Legend

X =

Y =

State =

D1 =

D2 =

D3 =

D4 =

Dear _____ :

This responds to your letter dated, August 30, 2004 on behalf of X, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

STATEMENT OF FACTS

According to the information submitted and representations therein, X incorporated under the laws of State and elected S corporation status effective D1. On D2, X transferred to Y a common stock purchase warrant ("Warrant") for X stock. On D3, it was determined that the issuance of the Warrant may have created a second class of stock terminating X's S corporation election. When X discovered that it may have issued a second class of stock, X took immediate steps to eliminate the Warrant on D4 and submitted this request for a ruling.

X represents that the issuance of the Warrant was not motivated by tax avoidance and that X was unaware that issuance of the Warrant would create a second class of stock.

LAW AND ANALYSIS

Section 1361(a)(1) defines an S corporation as a small business corporation for which an election under 1362(a) is in effect. Section 1361(b)(1) defines "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, other than a trust described in § 1361(c)(2), and other than an organization described in (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(d)(2)(A) of the Code provides that an election to be treated as an S corporation terminates whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the date the S corporation ceases to meet the requirements of a small business corporation. Section 1362(d)(2)(B). Section 1362(f), in relevant part, provides that if (1) an election to be treated as an S corporation was terminated under § 1362(d), (2) the Secretary determines that the termination was inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in the termination, steps were taken so that the corporation is once more a small business corporation, 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 adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the terminating event, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

CONCLUSION

Based upon the information submitted and the representations set forth above, we conclude that if X's S corporation election terminated on D2 when it transferred a common stock purchase warrant to Y, the 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 D2 and thereafter, provided that X's subchapter S election is not otherwise terminated under § 1362(d).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above described facts under any other provision of the

Code. In particular, no opinion is expressed or implied concerning whether X's election was valid under § 1362.

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.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

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

Enclosures (2)
Copy of this Letter
Copy of Section 6110 purposes