

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:1-PLR-138131-02
Date:
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Legend:

X =

A =

B =

C =

D =

a =

b =

c =

State =

D1 =

D2 =

D3 =

D4 =

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Dear _____ :

This responds to your letter, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

Facts

X was incorporated in State. X made an S election effective D1. On D2, X and its shareholders, A, B, C, and D, executed a shareholders' agreement that defined the rights, obligations, restrictions, terms, and conditions concerning disposition of shares of X. The shareholders' agreement contained an anti-dilution clause. At the time of the agreement, A and B each held a shares, C held b shares, and D held c shares of X. The anti-dilution clause was applicable to only c of a shares held by each of A and B. All individuals who acquired shares of X on later dates executed agreements consenting to the anti-dilution clause.

On D3, X and its shareholders terminated the shareholders' agreement. On D4, all outstanding shares of X were acquired by another company. X represents that the anti-dilution clause has never been invoked.

X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

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 a "small business corporation" as a domestic corporation which is not an ineligible corporation 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 subsection (c)(2)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at

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any time during the period of inadvertent termination of the S election, 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 termination, the corporation is treated as an S corporation during the period specified by the Secretary.

Conclusions

Based solely on the facts submitted and representations made, we conclude that, to the extent the shares of X subject to the anti-dilution clause constitute a second class of stock, any termination of X's S election as a result of the execution of the agreement containing the anti-dilution clause constitutes an inadvertent termination within the meaning of § 1362(f). Accordingly, under the provisions of § 1362(f), X will be treated as being an S corporation from D2 and thereafter, provided that X's S election was otherwise valid and has 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 facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X is a valid S corporation.

This ruling is directed only to the taxpayer requesting 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 forwarded to X.

Sincerely,

Dianna K. Miosi
Chief, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

Copy of this letter
Copy for § 6110 purposes