Internal Revenue Service

Department of the Treasury

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Date:
August 20, 1999

X =

Y =

A =

B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to a February 18, 1999, ruling request and subsequent correspondence submitted on behalf of X by its authorized representative, concerning relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on Date 1 and began business on Date 2. X elected to be an S corporation under § 1362(a) of the Code effective Date 2. The shareholders of X are A and B. Y was incorporated on Date 3 with equal shareholders, A and B.

As a consequence of a number of issues concerning Y's

growth and expansion, pursuant to a plan of reorganization, Y became a wholly owned subsidiary of X on Date 4. Thus, X's S corporation election terminated on Date 4. On Date 5, also pursuant to the plan of reorganization, Y was liquidated into X.

The shareholders of X and Y represent that they were not aware that the transaction could terminate X's S corporation election. In addition, the shareholders represent that the termination was not for purposes of tax avoidance or any type of retroactive tax planning. X and its shareholders represent that they have filed their respective tax returns consistent with the treatment of X as an S corporation. Further, 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.

Section 1361(a) of the Code 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)(1) of the Code defines the term "small business corporation" as a domestic corporation which is not an ineligible corporation.

For taxable years beginning on or before December 31, 1996, under § 1361(b)(2)(A) of the Code the term "ineligible corporation" included any corporation which is a member of an affiliated group (determined under § 1504 without regard to the exceptions contained in § 1504(b)). However, effective for taxable years beginning after December 31, 1996, the term "ineligible corporation" no longer includes a corporation that is a member of an affiliated group.

Section 1362(d)(2)(A) of the Code provides that an election under § 1362(a) shall terminate whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is a small business corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) will be effective on and after the date of cessation.

Section 1362(f) of the Code provides, in part, that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 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 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 any time during the

period specified pursuant to this subsection, 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 will be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts and representations submitted, we hold that X terminated its election to be an S corporation on Date 4 as a result of X becoming the 100 percent owner of Y. We also hold that the termination was inadvertent within the meaning of § 1362(f) of the Code.

We further hold that under the provisions of § 1362(f) of the Code, X will be treated as continuing to be an S corporation from Date 4 to Date 5, and thereafter provided that X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d). As shareholders, A and B must report their pro rata shares of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this ruling will be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, we express no opinion concerning the proper characterization of the transactions of Date 4 and Date 5 by X, Y, and their shareholders.

This ruling is directed to the taxpayer who requested 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, a copy of this letter is being sent to X's authorized representative.

Sincerely,
H. GRACE KIM
Assistant to the Chief
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of letter
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