Internal Revenue Service

Department of the Treasury

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Person to Contact:

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LEGEND

Company =

LLC =

State =

d1 =

d2 =

d3 =

d4 =

d5 =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

Dear

This letter responds to your letter on behalf of Company, dated May 17, 2000, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

FACTS

Company incorporated under State law on d1, and elected to be treated as a subchapter S corporation under § 1362 on d2. The shareholders of Company are A, B, C, D, E, F, G, H, I, and J. On d3, E transferred all of his shares of Company stock to LLC, a family limited partnership. Neither E, nor the other shareholders of Company were aware that LLC was an ineligible shareholder of an S corporation, and that the transfer would terminate Company's S corporation election.

In d4, Company retained a new accountant to prepare its tax returns. This accountant discovered that Company's S election had terminated on d3 because of E's transfer of Company stock to LLC. On d5, E reacquired the shares from LLC.

Throughout the termination period, Company consistently filed its returns as if it were an S corporation. Company and its shareholders represent that the termination of its election was neither intentional, nor motivated by tax avoidance or retroactive tax planning. Company and all of the shareholders who were shareholders during the period of termination agree to make any adjustments that the Secretary may require consistent with treating Company as an S corporation, including, but not limited to, the reallocation of the items of income and loss from LLC (and its members) back to E.

LAW AND ANALYSIS

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

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(f) provides, in part, that if (1) an election under § 1362(a) 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 is a small business corporation, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified 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 termination period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

After applying the relevant law to the facts submitted and representations made, we conclude that Company's S corporation election terminated on d3, when E transferred his shares of Company to LLC, an ineligible shareholder. Further, we rule that the termination was inadvertent within the meaning of § 1362(f). Under § 1362(f), Company will be treated as if it were an S corporation from d3 until d5 and thereafter, provided Company's S corporation election was valid and not otherwise terminated under § 1362(d). During the termination period, E shall be treated as owning the stock that he transferred to LLC. Accordingly E, and Company's other shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately and nonseparately computed items of Company as provided in § 1367, and take into account any distributions made by Company as provided by § 1368. If Company, or any of the shareholders fail to treat Company as described above, this ruling shall be void.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on

examination

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express no opinion whether Company is otherwise qualified to be an S corporation.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely Yours,

/s/

Robert Honigman
Acting Assistant to the Chief
Branch 3
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)