Internal Revenue Service

Number: **200138009**
Release Date: 9/21/2001
Index Number: 1362.04-00

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3-PLR-116138-00
Date:
June 20, 2001

Legend

Company =

Shareholder A =

Shareholder B =

Date 1 =

Date 2 =

Date 3 =

Dear

This letter responds to a letter dated August 10, 2000, and subsequent correspondence, written on behalf of Company, requesting relief under § 1362(f) of the Internal Revenue Code for the inadvertent termination of Company's S corporation election.

FACTS

The following facts have been represented. Company is a domestic corporation that elected S corporation status under §1362(a) on Date 1. On Date 2, Shareholder A transferred shares of Company's stock to Shareholder B, a nonresident alien. Shareholder A was unaware that Shareholder B was a nonresident alien and that the transfer would terminate Company's S corporation election. When Company realized that Shareholder B was an ineligible shareholder, Shareholder B transferred all of his shares of Company's stock to Shareholder A on Date 3.

Company and Shareholder A represent that they did not intend to terminate Company's S election when Shareholder A transferred Company's stock to Shareholder B. Shareholder A has agreed to amend prior returns to take into account the tax items that were previously allocated to Shareholder B.

DISCUSSION

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)(C) provides that, in order to be a small business corporation, a taxpayer cannot have a nonresident alien as a shareholder.

Section 1362(d)(2)(A) provides that an election to be treated as a subchapter 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) such corporation ceases to be a small business corporation. Under § 1362(d)(2)(B), the termination is effective on and after the date the S corporation ceases to meet the requirements of a small business corporation.

Section 1362(f) provides, in relevant part, that, if (1) an election under § 1362(a) by any 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 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 any 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 an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that Company's election to be treated as an S corporation terminated on Date 2 when Shareholder A transferred Company stock to Shareholder B. We also conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f).

Under § 1362(f), Company will be treated as continuing to be an S corporation from Date 2 to Date 3, and thereafter, provided that Company's S corporation election was valid and was not otherwise terminated under § 1362(d). During the applicable period, Shareholder A must, in determining her federal income tax liability, take into account Shareholder B's pro rata share of the separately and nonseparately computed items of Company as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by Company as provided in § 1368. If Company, or its shareholders, fail to comply with these conditions, this ruling will be null and void.

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

Code. Specifically, no opinion is expressed concerning whether Company is an S corporation for federal tax purposes.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

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.

Sincerely yours,
Mary Beth Collins,
Assistant to the Branch Chief
Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (1)
Copy for section 6110 purposes