Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2 - PLR-111576-01
Date:
June 27, 2001

X =

A =

B =

C =

D =

Corp =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

Dear :

This letter responds to your letter, dated January 18, 2001, and subsequent correspondence, submitted by you as X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

X is a corporation that made an S corporation election under § 1362(a) effective D1. On D2 and D3, A and B sold stock in X to Corp, a C corporation, whose individual shareholders are C and D. A and B did not realize that Corp's ownership of X stock would

terminate X's S election. In D4, the shareholders of X were informed by an accountant that the transfer of X stock to Corp terminated X's S election. In D5, Corp agreed to transfer its X stock to C and D effective as of the date Corp acquired the stock. On D6, Corp transferred all its X stock to C and D.

X, and its shareholders, agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require for the period of termination.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under section 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that 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) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under section 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 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 under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts and the representations submitted, we conclude that X's S corporation election terminated on D2 when Corp, an ineligible S corporation shareholder, acquired X stock. We also conclude that the termination was inadvertent within the meaning of § 1362(f).

Under the provisions of § 1362(f), X will be treated as

continuing to be an S corporation from D2 to D6, and thereafter, provided that X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d). During the period from D2 to D6, C and D will be treated as the owners of the X stock sold to Corp. Therefore, the shareholders of X, must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to 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 letter 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, including whether X was or is a small business corporation under § 1361(b) of the Code.

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.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X and X's other authorized representative.

Sincerely yours,
J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
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