Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
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X =

LLC =

A =

B =

C =

D =

E =

F =

G =

H =

D1 =

D2 =

D3 =

D4 =

D5 =

State =

M =

Dear :

This letter responds to a letter dated November 26, 2000, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X elected to be an S corporation for the taxable year ending on D1. On or about D2, A, a shareholder of X, gifted her M shares of X to each of her seven children, B, C, D, E, F, G, and H, in equal parts. LLC, a partnership for federal tax purposes, was formed in State on D3. On D3, interests in LLC were issued to each of A's children. Although A's children did not formally transfer their shares in X to LLC, the shareholders of X represent that it was understood that A's children received their interests in LLC in exchange for their X stock and that LLC was the beneficial owner of such stock. X and its shareholders were not aware that LLC was not an eligible shareholder of X.

X and its shareholders represent that A's children would not have transferred their stock to LLC if they had been aware that such transfer would result in the termination of X's S election.

In D4, B's accountant, while preparing B's individual returns, discovered that LLC was an ineligible shareholder of X. At that time, B's accountant informed A's children that LLC's ownership of X stock caused X's S corporation election to terminate. On D5, all shares of X owned by LLC were distributed to B, C, D, E, F, G, and H, in equal parts.

X represents that the circumstances resulting in the termination of X's election to be an S corporation were inadvertent. X also represents that X and its shareholders did not intend to engage in tax avoidance or retroactive tax planning. X and each person who was or is a shareholder of X at any time from D2 through D5 agree to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) 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)(B) provides that a “small business corporation” cannot 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 first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation is a small business corporation, or to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agree 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 such ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we conclude that X’s election to be an S corporation terminated on D2 because LLC was an ineligible shareholder. We also conclude that the termination of X’s S corporation election was inadvertent within the meaning of § 1362(f). Under the provisions of § 1362(f), X will be treated as an S corporation from D2 to D5, and thereafter, provided that X’s election to be an S corporation was not invalid and provided that the election was not otherwise terminated under § 1362(d). From D2 to D5, X’s shareholders (including LLC) must include their pro rata share of the separately and non-separately computed items as provided in § 1366, make adjustments to stock basis as provided in § 1367, and take into account any distributions made by X as provided by § 1368. If X, or any of X’s shareholders, fail to treat themselves as described above, this ruling shall 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 regarding whether X is otherwise eligible to

be an S corporation.

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.

In accordance with the power of attorney on file with this office, we are forwarding a copy of this letter to X.

Sincerely yours,
Matthew Lay
Senior Technician Reviewer
Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes