

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

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PLR-132669-05

Date: May 10, 2006

Legend:

X =

State =

Year1 =

Year2 =

Year3 =

Date1 =

Date2 =

a =

Dear :

This is in response to your letter dated June 3, 2005, submitted on behalf of X, requesting rulings under §§ 1361 and 1371 of the Internal Revenue Code.

Facts

According to the information submitted, X, a State corporation, adopted an employee stock ownership plan (ESOP) in Year1. The ESOP has owned all shares of X stock from Year2. X made an S election effective Date1.

Under the diversification provisions in the ESOP, some of the ESOP participants received shares of X stock on Date2. Those shares were immediately purchased by X. In order for X to have no more than 100 shareholders on Date2, the diversification distributions were made to batches of a ESOP participants at a time. For each batch of a ESOP participants, the time of the distribution of the shares by the ESOP and the time of the purchase of the shares by X were recorded in X's stock ledger. Only after the shares distributed to one batch were completely purchased by X, the shares for the next batch were distributed out. At no point in time during Date2, were shares of X stock held by more than 100 shareholders.

X requests the following rulings.

1. The distributions of shares to more than 100 ESOP participants which occurred throughout the day on Date2 did not terminate X's status as an S corporation by violation of the 100 shareholder requirement of § 1361(b)(1)(A).
2. For purposes of § 1377(a) and § 1.1377-1(a)(2)(ii) of the Income tax Regulations, S corporation income shall not be allocated to an ESOP participant who received a distribution of shares that were repurchased by X on the same day as the distribution.

Law and Analysis

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not – (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1377(a)(1) provides that except as provided in § 1377(a)(2), each shareholder's pro rata share of any item for any taxable year shall be the sum of the amounts determined with respect to the shareholder – (A) by assigning an equal portion of such item to each day of the taxable year, and (B) then by dividing that portion pro rata among the shares outstanding on such day.

Section 1.1377-1(a)(2)(ii) provides in part that a shareholder who disposes of stock in an S corporation is treated as the shareholder for the day of the disposition.

Conclusions

Based solely on the facts and representations submitted, we conclude the following.

1. The distributions of shares of X stock to batches of a ESOP participants at a time on Date2 did not terminate X's status as an S corporation under § 1362(d)(2)(A).
2. For purposes of § 1377(a) and § 1.1377-1(a)(2)(ii), the income of X will not be allocated to an ESOP participant who received a distribution of shares on Date2 that were immediately repurchased by X the same day. For purposes of § 1377(a)(1), the ESOP is treated as the shareholder for the day of the disposition, Date2, under § 1.1377-1(a)(2)(ii).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts of this case under any other provisions of the Code. Specifically, no opinion is expressed concerning whether X otherwise satisfies the S corporation eligibility requirements under § 1361.

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's authorized representatives.

Sincerely,

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter;
Copy for § 6110 purposes

cc: