Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200131019**
Release Date: 8/3/2001
Index Number: 1362.04-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:P&SI:3 PLR-113788-00
Date:
May 3, 2001

LEGEND:

X =

Y =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

n =

Shareholders =

Dear

This letter responds to your letter dated July 7, 2000, and subsequent correspondence written on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X incorporated on D1 and became an S corporation effective D2. In D3, X purchased a n percent interest in a foreign subsidiary, Y, which caused X to become a member of an affiliated group under § 1504. At the time of the purchase, a corporation that was a member of an affiliated group was an ineligible corporation under § 1361(b)(2)(A). As a result, X's subchapter S election terminated under § 1362(d)(2) in D3.

X represents that as soon as the termination was brought to its attention it took steps to obtain relief. X represents that it did not intend to terminate its subchapter S election and that events resulting in the termination were not motivated by tax avoidance or retroactive tax planning. X and its Shareholders continued to file tax returns as if X was an S corporation. Further, X and its Shareholders agree to make any adjustments that may be required consistent with the treatment of X as an S corporation.

X also makes the following representations: (1) X will file Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations, for tax years D4 through D5; (2) Y did not have any subpart F income during tax years D4 through D6; (3) none of the income, gain, loss, deduction, or credits of Y were reported on the tax return of X; and (4) X has no current intention to dispose of any interest in Y.

LAW AND ANALYSIS

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 section 1362(a) is in effect for such year.

Section 1361(b)(1) defines a small business corporation, in part, as a domestic corporation which is not an ineligible corporation.

Section 1361(b)(2)(A), as in effect for taxable years beginning on or before December 31, 1996, provided that for purposes of § 1361(b)(1), the term "ineligible corporation" means any corporation that is a member of an affiliated group (determined under § 1504 without regard to the exceptions contained in § 1504(b)). However, effective for taxable years beginning after December 31, 1996, the term ineligible corporation no longer includes a corporation that is a member of an affiliated group.

Section 1362(d)(2)(A) provides that an S election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of the termination.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the 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 in 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 with respect to such 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.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24, in discussing § 1362(f) of the Code, states in part:

> If the Internal Revenue Service determines that a corporation's subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and the shareholders agree to be treated as if the election had been in effect for such period.
>
> The Committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequences of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that taxpayers and the government will work out agreements that protect the revenues without undue hardship to taxpayers. . . . It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

CONCLUSION

After applying the law to the facts submitted and the representations made, we conclude that X's S corporation election under § 1362(a) was terminated when X purchased a n percent interest in Y. We conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f). Therefore, under the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D3, and thereafter, provided that X's S corporation election was valid and has not otherwise

terminated under § 1362(d).

This ruling is contingent on X and all of its Shareholders treating X as having been an S corporation for the period beginning D3, and thereafter. Accordingly, all of the Shareholders in X, in determining their respective income tax liabilities for the period beginning D3, and thereafter, must include their pro rata share of the separately and nonseparately computed items of X under § 1366, make adjustments to stock basis under § 1367, and take into account any distributions made by X under § 1368. If X or its Shareholders fail to treat X as described above, this ruling shall be null and void.

Additionally, this ruling is conditioned on X filing a Form 5471 for tax years D4 through D5. Penalties and interest might be applicable to the late filing of the Forms 5471. The rulings contained in this letter are predicated upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for a ruling. Verification of this information, representations, and other data may be required as part of the audit process.

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.

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.

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

Sincerely yours,

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

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes