

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:2-PLR-122907-01

Date:

August 22, 2001

Legend

X:

A:

State:

D1:

D2:

D3:

D4:

Dear _____ :

This responds to the letter dated April 19, 2001, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The represented facts are as follows: X was incorporated under State law and filed an election to be treated as an S corporation under § 1362 for its first taxable year beginning D1.

On D2, X issued shares of X stock to A, a State limited liability partnership. In D3, X's accountant discovered that X had issued stock to A, an ineligible shareholder, and that X's S corporation election had terminated on D2.

On D4, X and A executed an agreement rescinding the issuance of X stock to A. X and its shareholders have agreed to make any adjustments that the Commissioner may require consistent with treatment of X as an S corporation. X represents that it did not intend to terminate its S election and that the issuance of stock to A was not motivated by tax avoidance.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to

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any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 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 one class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st 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) shall be effective on and after the date of cessation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 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 such 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 pursuant to § 1362(f), agrees 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 termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the information submitted and the representations made, we conclude that the termination of X's subchapter S election, as described above, was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation from D2, through D4, and thereafter provided that X's S election was valid and has not otherwise terminated under § 1362(d). A will be treated as a shareholder of X for the period from D2 through D4. Accordingly, A and X's other shareholders, in determining their federal tax liability for that period, must include their pro rata share of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X to shareholders as provided § 1368. This ruling shall be null and void if the requirements of this paragraph are not met.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the above-described facts under any other provision of the Code. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation.

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This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely yours,
Shannon Cohen
Assistant to the Branch Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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