Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-131129-04

Date:
November 04, 2004

Company:

Corporation:

IRA:

M:

N:

Shareholders:

State:

a:

b:

c:

d:

Dear :

This letter responds to your letter signed June 2, 2004, as well as additional correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code that the termination of Company's S corporation election was inadvertent. Company represents the facts as follows.

FACTS

Company was incorporated on a under the laws of State and elected under § 1362(a) to be an S corporation that same date.

Corporation purchased shares of Company on b. IRA, as directed by N, purchased shares of Company on c. Both Corporation and IRA are ineligible shareholders.

In d, accountants for Corporation, while preparing Corporation's income tax return, discovered the investment in Company. They notified both M, president and shareholder of Corporation, and Company of the termination of Company's S corporation election. At about the same time, accountants for Company, while preparing Company's income tax return, discovered the existence of the two ineligible shareholders and notified Company of the terminating event. Corporation transferred its Company shares to M, reporting the stock purchase as a cash distribution to M followed by M's purchase of the shares directly. Company returned the purchase money to IRA in exchange for its stock, and N then purchased the Company shares directly. Company promptly authorized its accountants to file this ruling request.

Company had no intention or desire to terminate its S corporation election. Company and Shareholders agree to make adjustments during the termination period (consistent with the treatment of Company as an S corporation) as might be required by the Service.

LAW

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, 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) terminates whenever the corporation ceases to be a small business corporation.

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 termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in 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 pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as might be required by the Secretary regarding this period, then, notwithstanding the circumstances resulting in termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner. In the case of a transfer of stock to an ineligible shareholder that causes an inadvertent termination under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of an S

corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent any loss of revenue due to a transfer of stock to an ineligible shareholder (e.g., a transfer to a nonresident alien).

CONCLUSION

Based on the facts and representations submitted by Company, we conclude that the termination of Company's S corporation election due to the transfer of Company stock to Corporation was inadvertent within the meaning of § 1362(f). Consequently, we rule that Company will continue to be treated as an S corporation from b, and thereafter, unless Company's S election otherwise terminates under § 1362(d).

As a condition for this ruling, Corporation and IRA must not be treated as shareholders for any time they held Company shares. Accordingly, for the time Corporation and IRA did hold Company shares, M and N must include the prorata share of the separately and nonseparately computed items attributable to those shares in their income as provided in § 1366, make adjustments to the stock basis of those shares as provided in § 1367, and take into account any distributions with respect to those shares as provided in § 1368.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied regarding the transactions and adjustments undertaken to make Company a small business corporation once more, or regarding Company's eligibility to be an S corporation.

Under a power of attorney on file with this office, we are sending the original of this letter to you and a copy to Company.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

/s/

MARY BETH COLLINS
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy of this letter
copy for § 6110 purposes

cc: