

**Internal Revenue Service**

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Person To Contact:

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Date:

October 03, 2005

Legend

X =

A =

LLC =

LP =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear

This letter responds to a letter dated May 27, 2005, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on Date 1 and elected to be an S corporation effective Date 1. At the time of the election, A was the sole

shareholder of X. On Date 2, A transferred all of his shares of X stock to LP, a State limited partnership. A and LLC, a State limited liability company, have at all times been the sole partners of LP. A was not aware that LP was an ineligible shareholder of an S corporation, and that the transfer would terminate X's S corporation election. On Date 3, A met with his attorney to discuss matters concerning X. It was during this meeting that A first learned that the transfer of all of his shares of X stock to LP terminated X's S election. On Date 4, LP distributed all of the shares of X stock back to A.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and each person who was or is a shareholder of X at any time since Date 2 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 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" means a domestic corporation that is not an ineligible corporation and that does not 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) 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 a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

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 such 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 of 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 for that period, then, notwithstanding the circumstances resulting in such termination, the 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 X's S election was terminated on Date 2 when LP, an ineligible

shareholder, acquired X stock. We also conclude that this termination was inadvertent within the meaning of § 1362(f).

Under § 1362(f), X will be treated as if it were an S corporation from Date 2 until Date 4 and thereafter, provided that X's S corporation election was valid and not otherwise terminated under § 1362(d). During the termination period, A shall be treated as owning the stock that he transferred to LP. Accordingly, A, in determining his respective income tax liabilities during the termination period and thereafter, must include his pro rata share of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or A fail to treat themselves as described above, this ruling shall be null and void.

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. Specifically, no opinion is expressed on whether X was otherwise eligible to be treated as 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.

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,

Beverly Katz  
Senior Technician Reviewer, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)  
Copy of this letter  
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