

INTERNAL REVENUE SERVICE
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March 17, 1999

X

A =

B =

C =

D =

E =

F =

G =

H =

I =

State Y =

Country =

Firm =

Y =

z =

Dear :

This letter responds to a ruling request dated September 14, 1998, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code from an inadvertent termination of X's election to be an S corporation.

The information submitted states that X was incorporated in State Y on March 7, 1986, to hold and operate a hotel in State Y. X elected to be an S corporation effective April 1, 1986.

On October 3, 1997, A, who had been a resident alien shareholder of X from April 1, 1986, immigrated to Country. In addition, A filed Form "Abandonment of Lawful Permanent Resident Status" with the United States Department of Justice and returned A's green card. Consequently, A became a nonresident alien, which terminated X's S corporation election on October 3, 1997. A did not realize that becoming a nonresident alien would terminate X's S corporation election.

In January 1998, X's external accountants were informed that A had immigrated to Country. They subsequently informed X's management that a termination of X's S corporation election occurred when A became a nonresident alien. In March 1998, X hired Firm to prepare a letter ruling request. On June 1, 1998, A's shares in X were redeemed by X on an installment basis with an initial payment of y. The shares of X from October 3, 1997, to June 1, 1998, were owned by A, B, C, D, E, F, G, H and I.

B, the president of X, represents that X did not intend for its S corporation election to terminate. H, the Secretary of X, represents that at no time prior to X's external accountants informing X's management of the termination did X's management or any of its shareholders know that A's becoming a nonresident alien would terminate X's S corporation status. X, and its shareholders, have filed their tax returns for the 1997 taxable year, consistent with X being an S corporation. X's Form 1120S, U.S. Income Tax Return for an S Corporation, for 1997 shows ordinary income of z.

X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation.

A represents that A reported A's share of X's taxable income for the entire year of 1997. A represents that A will report and pay tax on A's share of X's taxable income for the 1998 taxable year for the period that A owned stock in X (through June 1, 1998) when A files A's U.S. individual income tax return for 1998. A also represents that A will report and pay U.S. federal income tax on the initial payment of y in redemption of A's ownership interest received on June 1, 1998, as well as subsequent payments to be received by A from X.

Section 1361(a)(1) of the Code 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)(C) of the Code provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have a nonresident alien as a shareholder.

Section 1362(d)(2)(A) of the Code provides that an election under § 1362(a) will 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)(A) shall be effective on and after the date of cessation.

Section 1362(f) of the Code provides that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) or to obtain shareholder consents or was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or the termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation is a small business corporation or to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, 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 ineffectiveness or 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 as follows:

X's S corporation election terminated under § 1362(d)(2) of the Code on October 3, 1997, as a result of A becoming a nonresident alien and the termination was "inadvertent" within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f) of the Code, X will be treated as continuing to be an S corporation from October 3, 1997 to June 1, 1998, and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d). During the period from October 3, 1997 to June 1, 1998, X's shareholders, including A, must, in determining their federal income tax liability, 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 as provided in § 1368. In addition, A must report and pay U.S. federal income tax on the initial payment of y received in redemption of A's ownership interest on June 1, 1998, as well as subsequent installment payments to be received by A from X. If X or its shareholders fail to treat themselves as described above, this ruling will 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.

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 will be sent to X's authorized representatives.

Sincerely yours,

H. GRACE KIM
Assistant to the Chief
Branch 2
Office of the Assistant
Chief Counsel

-5-

(Passthroughs and Special
Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes