

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

January 31, 2000

X =

Y =

A =

B =

D1 =

D2 =

D3 =

D4 =

Year 1 =

Year 2 =

x =

Dear :

This letter responds to a letter dated September 29, 1999, and subsequent correspondence submitted by X's authorized representative on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1 of Year 1. A, X's president, represents that X elected to be an S corporation effective for its Year 1 taxable year. On D2 of Year 1, a certificate for x shares of X stock was issued in the name of B, an individual. B's business manager notified A that the certificate should be reissued to Y, an S corporation whose sole shareholder is B. A informed X's incorporating attorney, who prepared a new certificate in the name of Y. A represents that X's incorporating attorney was unaware of the applicable tax rules regarding subchapter S.

On D3 of Year 2, at a meeting to review X's tax returns, X's tax attorney informed X that Y was not an eligible subchapter S shareholder and that the issuance of X stock to Y had terminated X's S corporation election. B agreed to hold the X stock as an individual. On D4 of Year 2, X issued a new certificate in the name of B with an effective date of D2 of Year 1.

A represents that X never intended to terminate its S corporation election and that X was unaware of the termination of its S corporation election until informed by X's tax attorney on D3 of Year 2. X and its shareholders have filed all tax returns consistent with the treatment of X as an S corporation. X and its shareholders consent to make adjustments consistent with the treatment of X as an S corporation from and including D2 of Year 1 to D4 of Year 2.

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

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.

For taxable years beginning on or before December 31, 1997, § 1361(b)(1)(B) provided that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2)) who is not an individual.

Section 1362(d)(2)(A) 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 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 (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or 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 (A) so that the corporation is a small business corporation, or (B) 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 § 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 ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted, and the representations made, we conclude that the termination of X's S corporation election occurred on D2 of Year 1, as a result of Y becoming a shareholder of X. We further conclude that the termination was an "inadvertent termination" within the meaning of § 1362(f).

We further hold that under the provisions of § 1362(f) of the Code, X will be treated as continuing to be an S corporation from D2 of Year 1 to D4 of Year 2, and thereafter, provided that X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d). During the period from D2 of Year 1 to D4 of Year 2, B will be treated as a shareholder of X. As a shareholder of X, B must report B's 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. If X or its shareholders fail to treat X as described above, this ruling will be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code.

This ruling is directed only to the taxpayer that 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,
J. THOMAS HINES
Acting Branch Chief Branch 2
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

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