

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

September 13, 2000

X =

A =

D1 =

D2 =

D3 =

D4 =

D5 =

x =

State =

Court =

Foundation =

State Statute 1 =

State Statute 2 =

Dear :

This letter responds to a letter dated May 16, 2000, and subsequent correspondence, submitted by you on behalf of X, as the authorized representative of X, requesting a ruling that X's subchapter S election did not terminate on D3.

The information submitted states that X is a corporation organized under the laws of State. X filed an election to be treated as an S corporation effective for the taxable year beginning D1. A, the secretary of X, represents that X filed its federal income tax return for that year and all following taxable years as an S corporation.

A instructed A's attorney to form a charitable private foundation under the laws of State. A intended that the private foundation qualify as an organization exempt from tax under

§ 501(c)(3). On D2, Foundation was incorporated pursuant to State Statute 1. On or about D3, A transferred x shares of X stock to Foundation. A represents that at the time of the transfer, A believed Foundation was a tax-exempt organization under § 501(c)(3).

During D4, X's tax advisors, in the course of preparing a request for a ruling that Foundation was an organization exempt from tax under § 501(c)(3), discovered that Foundation had been erroneously incorporated under State Statute 1. Under the laws of State, non-profit organizations are incorporated under State Statute 2. In addition, it was determined that Foundation's Articles of Incorporation failed to include certain required language to ensure its qualification under § 501(c)(3). Therefore, Foundation was not an organization exempt from tax under § 501(c)(3).

The shareholders of X have a shareholders' agreement in effect. A represents that, in general, under this agreement, a shareholder desiring to transfer shares of X must obtain the consent of the other shareholders prior to transfer. A further represents that the other shareholders of X consented to A's transfer of X shares to Foundation on the condition that no adverse legal, tax, or other consequences would result to X or its shareholders and with the understanding that Foundation was an eligible S corporation shareholder.

On D5, Court issued an order that the transfer of X shares to Foundation on or about D3 is void ab initio, and in all respects is set aside as if the transfer had never occurred, and the parties thereto are returned to the respective positions they were in prior to the transfer.

Section 1362(a) 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) 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.

Sections 1362(d)(2)(A) provides that an S election terminates whenever (at any time on or after the 1<sup>st</sup> day of the 1<sup>st</sup> taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Based solely on the facts and representations submitted, because A's transfer of X shares to Foundation was void ab initio under State law as determined by Court, we conclude that X's S corporation election did not terminate on D3. Accordingly, as

Foundation was never a shareholder of X, X will be treated as continuing to be an S corporation from D3, and thereafter, provided X's S corporation election was valid, and has not otherwise terminated under the provisions of § 1362(d).

X and all its current and prior shareholders must treat X as having been an S corporation for the period from D3 to the present. In addition, X and its shareholders must treat A as having been the shareholder of the X shares which A attempted to transfer to Foundation and amend any prior tax returns that are inconsistent with this treatment.

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, including whether X was or is a small business corporation under § 1361(b) 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 is being sent to X.

Sincerely yours,  
J. THOMAS HINES  
Acting Branch Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2  
Copy of this letter  
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