

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

July 1, 2003

X =

Trust 1 =

Trust 2 =

LLC =

A =

B =

C =

D =

E =

F =

G =

State =

D1 =

D2 =

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D3 =

D4 =

D5 =

D6 =

D7 =

D8 =

m =

Dear :

This responds to a letter dated April 14, 2003, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X, incorporated under the laws of State, elected to be an S corporation effective D1. On D2, A transferred m shares of X stock to Trust 1, and B transferred m shares of X stock to Trust 2. Trust 1 and Trust 2 were each a trust all of which was treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States. On D3, the shares of X stock held by Trust 1 and Trust 2 were transferred on behalf of C, D, E, F, and G to LLC, a limited liability company classified as a partnership for federal tax purposes. C, D, E, F, and G each owned a 20% interest in LLC.

X represents that X, X's shareholders, and LLC were unaware that LLC's ownership of X's stock terminated X's election to be an S corporation. On D6, X's accountant informed A, X's president, that X's election to be an S corporation terminated on D3. On D7, F died and his interest in LLC was transferred to his estate. On D8, LLC distributed its shares of X stock to its members.

X represents that the members in LLC have properly reported their distributive shares of LLC's pro rata share of X's income, gain, loss, deductions, and credits for the period D3 through D4.

X represents that the circumstances resulting in the termination of X's S corporation election on D3 were inadvertent. Additionally, X represents that X and its shareholders did not intend to engage in tax avoidance or retroactive tax planning. X

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and each person who was or is a shareholder of X 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.

Law and Analysis

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.

Section 1361(b)(1)(B) provides that a “small business corporation” cannot 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 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1362(d)(2)(A) 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 the termination shall be effective on and after the date of cessation.

Section 1362(f) 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 § 1362(d)(2) or (3), (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 in 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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusions

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Based solely on the representations made and the information submitted, we conclude that X's S corporation election terminated on D3, because X stock was transferred to LLC, an ineligible shareholder of an S corporation. We further conclude that the termination of X's S election was an inadvertent termination within the meaning of § 1362(f). Under the provisions of 1362(f), X will be treated as an S corporation from D3 to D8, and thereafter, provided that X's election to be an S corporation was not invalid and provided that the election was not otherwise terminated under § 1362(d). From D3 to D8, X's shareholders (including LLC) must include their pro rata share of the separately and non-separately state computed items as provided in § 1366, make adjustments to stock basis as provided in 1367, and take into account any distributions made by X as provided by § 1368. Additionally, from D5 to D8, the members of LLC must properly report their distributive shares of LLC's pro rata share of X's income, gain, loss, deductions, and credits. If X or any of X's shareholders fail to treat themselves as described above, this ruling shall 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. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation.

This ruling letter 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 the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely yours,
MATTHEW LAY
Senior Technician Reviewer, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

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