

Internal Revenue Service

Department of the Treasury

Index Number: 1362.04-00

Washington, DC 20224

Number: 200041014

Person to Contact:

Release Date: 10/13/2000

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:2 - PLR-106002-00

Date:

July 11, 2000

X =

Y =

Z =

A =

B =

Trust =

D1 =

D2 =

D3 =

D4 =

Year 1 =

Year 2 =

x =

y =

z =

Dear :

This letter responds to a letter dated March 8, 2000, 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. A, the president of X, represents that X elected to be an S corporation effective upon incorporation. A further represents that on D2 of Year 1, X attempted to issue x shares of X stock to Trust and y shares of X stock to B. However, the keeper of X's

corporate stock book and ledger mistakenly issued all of the X stock, a total of z shares, to Y, which was not an eligible subchapter S shareholder.

On D3 of Year 2, the president of Y informed X of the error in the issuance of the stock. The stock was reissued to the proper shareholders, but X did not realize that its S corporation election may have terminated because of the original error.

On D4 of Year 2, X became a wholly-owned subsidiary of Z. An attorney retained by X to advise X in connection with this transaction discovered that X's S corporation election may have terminated as of D2 of Year 1 and informed X of the possible termination.

X represents that neither tax avoidance nor retroactive tax planning motivated the possible termination of X's S corporation election. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation from 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 a termination of X's S corporation election may have occurred on D2 of Year 1, as a result of Y purportedly becoming a shareholder of X on that date. We further conclude that any such 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, 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, Trust and B will be treated as shareholders of X. As shareholders of X, Trust and B must report their pro rata shares 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