Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2-PLR-120775-01
Date:
August 20, 2001

Legend

X:

Y: .

A:

B:

C:

D1:

D2:

D3:

D4:

D5:

D6:

d:

Dear :

This letter responds to your representative's letter dated March 6, 2001, submitted on behalf of X, requesting rulings under §§ 1362(g) and 1362(b)(5) of the Internal Revenue Code.

The represented facts are as follows: X was incorporated on D1, and elected S status for the taxable year ending D2. A was the sole shareholder of X. On D3, X entered into an agreement to acquire all of the business assets of Y. The agreement was amended on D4. Pursuant to the amended agreement, X acquired substantially all of the assets of Y in exchange for d shares of X's stock on D4. Under the terms of the

agreement, Y was required to immediately distribute the X stock received in the transaction to B, the sole shareholder of Y.

After D3 but prior to D4, C claimed an interest in Y, and, in particular, an interest in X's stock to be distributed to Y. On D4, prior to executing the agreement, B, by written affidavit, represented to X and A that no one other than B had a legitimate claim to the X stock that would be transferred to Y. The ownership dispute between B and C resulted in litigation that was not resolved until D5, when A purchased the d shares of X stock previously transferred to Y. Due to circumstances beyond X's control the X stock issued to Y was not immediately distributed to B on D4. X's S corporation election was terminated on D4 because Y failed to distribute X's stock to B.

X's articles of incorporation prohibit shareholders from selling or otherwise transferring any share in X if the transfer would cause X to lose its status as an S corporation unless or until X otherwise elects to terminate such status or the status is otherwise terminated. X and A represent that they did not intend to terminate X's S election through the acquisition of Y's assets in exchange for X stock.

X is requesting permission to reelect to be an S corporation effective D6, prior to the termination of the five-year waiting period imposed by § 1362(g). However, a Form 2553 (Election by Small Business Corporation) was not timely filed.

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

Section 1362(g) provides that if a small business corporation has made an election under § 1362(a) and if such election has been terminated under § 1362(d), the corporation (and any successor corporation) shall not be eligible to make an election under § 1362(a) for any taxable year before its fifth taxable year which begins after the first taxable year for which the termination is effective, unless the Secretary consents to the election.

Section 1.1362-5(a) of the Income Tax Regulations provides, in part, that the corporation has the burden of establishing that under the relevant facts and circumstances, the Commissioner should consent to a new election. The fact that more than 50 percent of the stock in the corporation is owned by persons who did not own any stock in the corporation on the date of the termination tends to establish that consent should be granted. In the absence of this fact, consent ordinarily is denied unless the corporation shows that the event causing termination was not reasonably within the control of the corporation or shareholders having a substantial interest in the corporation and was not part of a plan on the part of the corporation or of such shareholders to terminate the election.

Section 1362(b)(5) of the Code provides that if -- (A) an election under § 1362(a) is made for any taxable year after the date prescribed by § 1362(b) for making such election for such taxable year or no such election is made for any taxable year, and (B)

the Secretary determines that there was reasonable cause for the failure to timely make such election, the Secretary may treat such an election as timely made for such taxable year.

Based solely on the facts and the representations submitted, we conclude that the events causing the termination of X's S corporation election were not reasonably within the control of the corporation or shareholders having a substantial interest in the corporation, and were not part of a plan on the part of the corporation or of such shareholders to terminate the election. Therefore, consent is granted for X to make an election to be an S corporation effective D6.

In addition X has established reasonable cause for failing to make a timely election to be an S corporation effective D6. Accordingly, provided that X makes an election to be an S corporation by filing a completed Form 2553 with the appropriate service center effective D6, within 60 days following the date of this letter, then such election will be treated as timely made for X's taxable year beginning D6. A copy of this letter should be attached to the Form 2553.

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. In particular, no opinion is expressed or implied regarding X's eligibility to elect to be an S corporation.

A copy of this letter should be attached to X's federal income tax return for its taxable year for which the S corporation election is accepted as timely filed. A copy of this letter is being sent to X for that purpose.

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 and X's second authorized representative.

Sincerely yours,
Matthew Lay
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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