

Internal Revenue Service

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Refer Reply To:
CC:PSI:2-PLR-157641-01
Date:
March 25, 2002

X =

Y =

LLC =

A =

B =

C =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear

This responds to your letter dated September 24, 2001, together with subsequent correspondence, requesting relief under §1362(f) of the Internal Revenue Code.

The information submitted states that X was a corporation that elected to be treated as an S corporation effective on Date 1. On Date 2, LLC, a limited liability company owned by A, B, and C, acquired X stock. On Date 2, the owners of LLC were unaware that X was an S corporation. However, A, B, and C later discovered that X was an S corporation, and the LLC's ownership of X stock had terminated X's

S election. On Date 3, LLC's shares of X stock were distributed to A, B, and C. On Date 4, X's articles of incorporation were amended, changing the corporation's name to Y.

Y represents that the transfer of shares to an ineligible S corporation shareholder was not motivated by tax avoidance or retroactive tax planning.

Y (as the successor to X) and its shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require.

Section 1361(a)(1) of the Internal Revenue Code defines an "S corporation" means, as a small business corporation for which an election under §1362(a) is in effect for the taxable year .

Section 1361(b)(1)(B) provides that the term "small business corporation" is 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) or an organization described in §1361(c)(6)) who is not an individual.

Section 1362(d)(2) provides that an election under §1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under §1362(d)(2) is 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 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 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 X's S corporation election was terminated on Date 2 as a result of LLC, an ineligible S corporation shareholder, acquiring shares of X. In addition, we conclude

that this termination was inadvertent within the meaning of §1362(f). Under the provisions of §1362(f), X will be treated as continuing to be an S corporation from Date 2, and thereafter, provided that X's S election was valid and was not otherwise terminated. Accordingly, all of the shareholders in X, in determining their respective income tax liabilities for the period beginning Date 2 and ending on Date 3, must include their pro rata share of the separately stated and non-separately computed items of X as provided in §1366, make any adjustments to basis provided in §1367, and take into account any distributions made by X as provided in §1368. For the purposes of the preceding sentence, during the period from Date 2 to Date 3, A, B and C will be treated as owners of the stock held by LLC, and the ownership of X stock by LLC will be ignored. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

Except as specifically ruled upon above, we express no opinion concerning the Federal tax consequences of the transactions described above under any other provisions 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.

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

Enclosures: (2)
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