

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:3 PLR-129939-01

Date:

June 14, 2002

LEGEND

Company =

A =

Shareholders =

PLR-129939-01

2

New Shareholders =

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State =

Corporation =

LLC =

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Partnership =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

m =

n =

o =

p =

Dear :

This letter responds to a letter dated May 23, 2001, and subsequent correspondence, requesting inadvertent termination relief under § 1362(f) of Internal Revenue Code.

Facts

Company incorporated on Date 1 under the laws of State. Company elected to be an S corporation effective Date 2.

On Date 3, Company issued m shares of its stock to Corporation. On Date 4, Company issued an additional o shares of its stock to Corporation. Subsequently, on Date 6, Corporation contributed all of its Company stock (p shares) to LLC. Corporation is a member of LLC.

On Date 5, Company issued n shares of its stock to Partnership.

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On or about Date 7, Company learned that it had ineligible shareholders (LLC and Partnership) and, thus, its S corporation election had terminated on Date 3. Subsequently, remedial steps were taken to redeem all of Company's stock owned by the ineligible shareholders at a price equal to the ineligible shareholders' original purchase price for the stock. After the redemption, Company issued shares of its stock that had previously been owned by the ineligible shareholders to A (an individual shareholder of Corporation) and to the individual partners of Partnership (collectively New Shareholders). The above steps were completed on Date 8.

Company and its shareholders represent that the issuance of Company stock to Corporation and Partnership and the subsequent transfer of Company stock from Corporation to LLC were not intended to terminate Company's S corporation election. Additionally, Company and its shareholders represent that there was no intent to engage in tax avoidance or retroactive tax planning. Company and its shareholders agree to make any adjustments, consistent with the treatment of Company as an S corporation, that the Secretary may require with respect to the period of termination.

Applicable Law

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1361(a)(1) generally 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 the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not 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 1362(d)(2)(A) provides that an election under § 1362(a) is 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 such termination is effective on and after the date the S corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, agrees to make such

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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 the termination, such corporation is treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that, for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Conclusion

Based on the facts submitted and the representations made, we conclude that Company's S corporation election terminated on Date 3 when Company issued stock to Corporation, an ineligible shareholder. We also conclude that the termination was inadvertent within the meaning of § 1362(f). Therefore, Company will be treated as continuing to be an S corporation from Date 3 to Date 8, provided Company's S corporation election was not otherwise terminated under § 1362(d).

This ruling is contingent on Company and all of its shareholders treating Company as an S corporation from Date 3 to Date 8, and thereafter, and on Company treating Shareholders as the shareholders of Company during the inadvertent termination period. Accordingly, Shareholders, in determining their federal tax liability, must include their pro rata share of the separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company under § 1368. If Company or Shareholders fail to treat Company 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 the original election made by Company to be treated as an S corporation was a valid election under § 1362.

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

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being forwarded to your authorized representative.

Sincerely yours,
Mary Beth Collins
Senior Technician Reviewer,
Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes

cc: