

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:1-PLR-145459-02

Date:

March 12 2003

Legend:

X =

Z =

A =

B =

C =

D =

E =

a =

b =

D1 =

D2 =

D3 =

D4 =

Dear _____ :

This responds to your letter dated August 13, 2002, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

Facts

X was incorporated on D1. X elected S status effective D1, when it was owned equally by A and B. As of D2, A and B each owned a shares of X stock and C owned b shares of X stock.

On D3, A formed a partnership, Z, with D. On or about D3, A contributed all of his shares in X to Z. A and D then made a gratuitous transfer of a partnership interest to E. On D4, all X shares held by Z were distributed to A.

X represents that at all relevant times, X and its shareholders treated X as an S corporation and filed their tax returns accordingly. X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

Law and Analysis

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect.

Section 1361(b)(1)(B) provides that a small business corporation can 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) shall be terminated whenever the 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) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the 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 of the corporation at any time during the period of inadvertent termination of the S election, 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 the termination, the corporation is treated as an S corporation during the period specified by the Secretary.

The committee reports accompanying the Subchapter S Revision Act of 1982 explain § 1362(f) as follows:

If the Internal Revenue Service determines that a corporation's subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and the shareholders agree to be treated as if the election had been in effect for such period.

The Committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequences of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that taxpayers and the government will work out agreements that protect the revenues without undue hardship to taxpayers. ... It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24; H.R. Rep. No. 826, 97th Cong., 2d Sess. 12 (1982), 1982-2 C.B. 730, 735.

Conclusion

Based solely on the facts submitted and the representations made, we conclude that X's election to be treated as an S corporation terminated on or about D3. We also conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f). Under the provisions of § 1362(f), X will be treated as continuing to be an S corporation, provided that X's S corporation election is not otherwise terminated under § 1362(d).

During the period of termination, the shareholders of X, including Z, must include their pro rata share of the separately and nonseparately computed items of X under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by X to the shareholders under § 1368. If X or any of its shareholders fail to treat X as described above, this ruling will be null and void.

Except as specifically provide herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether X is an S corporation for federal tax purposes. In addition, no opinion is expressed as to the federal income tax consequences of the D4 distribution by Z. Finally, this letter does not address the gift tax consequences of the D4 distribution from Z to A of X stock. See, e.g., § 25.2511-1(h)(1) indicating that a transfer of property by an entity to B, an individual, would generally constitute a gift to B from the owners of the entity to the extent the distribution exceeds B's interest in such amount as an owner of the entity.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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Under a power of attorney on file in this office, a copy of this letter will be sent to X's authorized representative.

Sincerely,

/s/ Dan Carmody

Dan Carmody
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter

Copy for § 6110 purposes