

Internal Revenue Service

199934021
Department of the Treasury

Index Number: 1362.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:3 PLR-121140-98

Date:

May 21, 1999

LEGEND:

X =

A =

B =

C =

D =

E =

F =

G =

H =

I =

- J =

- D1 =
- D2 =
- D3 =
- D4 =
- D5 =
- D6 =
- D7 =
- D8 =
- c =
- d =
- e =
- Country M =
- Country N =

Dear

This letter responds to a letter dated, November 11, 1998, and subsequent correspondence, written on X's behalf, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated on D1 and in D2 elected to be an S corporation. On D3, X issued c shares of X's stock to A and B, and d shares to each C, D, E, F, G, H, I, and J. On D3, I was a resident alien of the United States.

134

On D4, I and her husband, H, moved to Country M and later to Country N. They remained out of the United States until D5. Consequently, it is represented that I became a nonresident alien on D6. In D7, X learned that its S corporation election may have inadvertently terminated on D6 when I became a nonresident alien, an ineligible S corporation shareholder. Subsequently, on D8, I gifted all of her X stock, e shares, to H, her husband. H represents that he is not holding X stock as a nominee for I, or anyone else.

X represents that the termination was inadvertent. X was unaware that I was an ineligible shareholder beginning on D6. X represents that it did not intend to terminate its S corporation election and that X and its shareholders have always treated X as an S corporation. X further represents that throughout all the years in question, H and I filed joint United States income tax returns. X and its shareholders (A, B, C, D, E, F, G, H, I, and J) agree to make any adjustments (consistent with the treatment of X as an S corporation) that may be required.

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)(C) provides that one of the requirements for a taxpayer to be a small business corporation is that the taxpayer cannot have a nonresident alien as a shareholder.

Section 1362(d)(2) provides that an election to be an S corporation will be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides that, (A) if an election under § 1362(a) by any corporation was terminated under § 1362(d)(2), (B) the Secretary determines that the termination was inadvertent, (C) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation is a small business corporation, and (D) 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 any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

The committee reports accompanying the Subchapter S Revision Act of 1982 Act 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.

CONCLUSIONS

X's S corporation election terminated on D6 when I became a nonresident alien, an ineligible S corporation shareholder. Based solely on the facts submitted and representations made, we conclude that the termination of X's subchapter S election on D6 was inadvertent within the meaning of § 1362(f).

Under § 1362(f), X will be treated as continuing to be an S corporation during the period from D6 to D8, and thereafter, provided that X's S corporation election is valid and is not otherwise terminated under § 1362(d). Accordingly, X's shareholders (A, B, C, D, E, F, G, H, I, and J), in determining their federal tax liability for the period from D6 to D8, 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 shareholders under § 1368. If X or its shareholders fail to treat X as described above, this ruling will be null and void.

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. Specifically, no opinion is expressed concerning whether X is an S corporation for federal tax purposes. Also, no opinion is expressed regarding the tax consequences of any gifts made by the shareholders.

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.

Under a power of attorney on file in this office, we are sending a copy of this letter to X.

Sincerely yours,

Donna M. Young

Donna M. Young
Senior Technician Reviewer,
Branch 3
Office of the Assistant Chief
Counsel
(Passthroughs and Special
Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes