Internal Revenue Service

Department of the Treasury

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Date:
September 10, 1999

Number: **199949020**
Release Date: 12/10/1999

X =

LLC =

A =

B =

C =

D =

D1 =

D2 =

D3 =

D4 =

Year 1 =

Dear :

This letter responds to your , July 23, 1999, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

X is a corporation that was incorporated on D1. X made an S corporation election under section 1362(a) effective for its Year 1 taxable year. On D2 A, X's sole shareholder, sold all of X's stock to LLC, a limited liability company, whose members were B, C, and D. B, C, and D were trying to insulate themselves from additional risk by creating an intervening entity, LLC, to own the stock of X. On D2, B, C, and D did not know and were not informed by X's accountant that A's transfer of X stock to LLC would terminate X's S election. The transfer of X stock to LLC

was not motivated by tax avoidance or retroactive planning. On D3, B and C purchased D's units in LLC. On D4, after X's new accountant learned that LLC owned shares of X stock, LLC distributed the X stock to B and C, so that LLC no longer owned shares of X.

X, LLC, B, C, and D agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require for the period of termination.

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

Section 1361(b)(1)(B) provides that a "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 section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual.

Section 1362(d)(2) provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the first day of the first 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 section 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under section 1362(a) by any corporation was terminated under section 1362(d)(2); (2) the Secretary determines that the circumstances resulting in such 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 of the corporation at any time during the period specified under section 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such 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 hold that X's S corporation election terminated on D2 when LLC, an ineligible S corporation shareholder, acquired X stock. We also conclude that the termination was inadvertent within the meaning of section 1362(f).

Under the provisions of section 1362(f), X will be treated as continuing to be an S corporation during the period from D2 to D4, and thereafter, provided that X's S corporation election was not otherwise invalid and provided that the election was not otherwise terminated under section 1362(d). Additionally, during the period from D2 to D4, B, C and D will be treated as the owners of the X stock held by LLC in proportion to their interest in LLC. Accordingly, B, C and D must include their pro rata share of the separately and nonseparately computed items of X as provided in section 1366. If X, B, C, or D fail to treat X as described above, this ruling shall 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, including whether X was or is a small business corporation under § 1361(b) of the Code.

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X.

Sincerely yours,

J. THOMAS HINES
Senior Technician Reviewer
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)