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November 5, 1999

X =

Y =

Z =

State =

Country W =

A =

B =

C =

D =

Dear :

This is in reply to your letter dated June 30, 1999, and subsequent correspondence, written on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code.

The information submitted states that X is a State corporation engaged in the accounts receivable collection business. X was incorporated on October 20, 1988, but was inactive until 1990. X's initial shareholders were A and B. X elected to be an S corporation effective March 10, 1990.

In 1995, A and B intended to expand X's business operations to Country W by forming a Country W business entity. However, contrary to A and B's intent and understanding that the shares be issued in their individual names, D, a Country W attorney, registered 99.9 percent of the shares of Y, a Country W company classified as an association taxable as a corporation for federal

tax purposes, in X's name on August 7, 1995. Thus, X's S corporation election terminated.

In 1998, Z proposed to acquire the stock of X and Y. As a result of the due diligence process, in or about August 1998, X and its shareholders were informed that the shares of Y were registered in the name of X. On or about November 19, 1998, the shares of Y were re-registered in the names of A and B. Y paid no dividends to X during the period X held Y stock.

In anticipation of the sale of X stock to Z, A and B transferred 225 shares of X to C on March 27, 1999, pursuant to C's employment arrangement with X. On March 30, 1999, Z acquired all of the stock of X from A, B, and C.

C, X's president, represents that the termination of X's S corporation election as a result of the registration of the shares of Y in the name of X did not result from retroactive tax planning and was not motivated by tax avoidance. X and each person who was a shareholder of X at any time during the termination period agree to make any adjustments, consistent with the treatment of X as an S corporation, as may be required by the Secretary with respect to that period.

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1) of the Code provides, in part, that the term "small business corporation" means a domestic corporation that is not an ineligible corporation.

Section 1361(b)(2)(A) of the Code, as in effect for taxable years beginning on or before December 31, 1996, provided that for purposes of section 1361(b)(1), the term "ineligible corporation" means any corporation that is a member of an affiliated group (determined under section 1504 without regard to the exceptions contained in section 1504(b)). However, effective for taxable years beginning after December 31, 1996, the term ineligible corporation no longer includes a corporation that is a member of an affiliated group.

Section 1362(d)(2)(A) of the Code provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) of the Code provides that if (1) an election under section 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of section 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 who was a shareholder in the corporation at any time during the period specified pursuant to section 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 presented and the representations made, we hold that X's election to be an S corporation terminated on August 7, 1995, as a result of the acquisition by X of 99.9 percent of the stock of Y. We also hold that the termination was inadvertent within the meaning of section 1362(f) of the Code.

We further hold that, pursuant to the provisions of section 1362(f) of the Code, X will be treated as an S corporation from August 7, 1995 to December 31, 1996, and thereafter, provided that X's election to be an S corporation was otherwise valid and was not terminated under section 1362(d). If X or its shareholders fail to treat X as described above, this letter will 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 provisions of the Code, including the federal tax consequences of the re-registration of the Y stock in the names of A and B.

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 being sent to X.

Sincerely yours

H. GRACE KIM
Assistant to the Chief
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of this letter
Copy for section 6110 purposes