Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

In Re:

Refer Reply To:
CC:PSI:3 – PLR-141045-03
Date:
August 27, 2004

Company =

State =

Shareholders =

a =

b =

c =

d1 =

d2 =

d3 =

d4 =

d5 =

d6 =

d7 =

E =

F =

G =

X =

Y =

Dear :

This letter responds to a letter dated June 30, 2003, and subsequent correspondence, submitted on behalf of Company requesting a ruling under § 1362(f) of the Internal Revenue Code.

Company was incorporated in State on d1. Company filed an election under § 1362(a) to be treated as an S corporation effective as of d2. Company currently has a shareholders, Shareholders. On d3, X, a corporation, acquired b shares of Company. As a consequence of the acquisition, Company's S corporation election terminated on d3, the date of the transfer of Company stock to X. In addition, Y, another corporation, owned c shares of Company from d4 to d5. As of d5, official ownership of Y's shares of Company had been transferred to F, a qualified individual.

The termination of Company's S election was discovered shortly after Company came under new management in d6. To correct the terminating event, X's shares of Company were transferred to E, a qualified individual, on d7.

Company represents that the termination of its S corporation election was inadvertent and unintended. Company further represents that during the time X held shares of Company, X's allocable S corporation income was reported on X's Form

1120, U.S. Corporation Income Tax Return. Furthermore, Company represents that during the time Y held shares of Company, Y's allocable S corporation income was reported on the Forms 1040, U.S. Individual Income Tax Returns, of F and G, who were Y's principals. Company represents that this resulted in no tax avoidance by Company or any of its shareholders. Company requests a ruling that the termination of its S corporation election was inadvertent within the meaning of § 1362(f).

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) 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 which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1362(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 (at any time on or after the first day of the taxable year for which the corporation is an S corporation) 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) or (3); (2) the Secretary determines that the circumstances resulting in 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 pursuant to § 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 the 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 conclude that Company's S corporation election was terminated on d3, when shares of Company's stock were first transferred to an ineligible shareholder, X. We also conclude that, if Company's S election had not terminated on d3, the election would have terminated on d4, when shares of Company's stock were transferred to Y, also an

ineligible shareholder. We further conclude that this termination was inadvertent within the meaning of § 1362(f).

Consequently, under the provisions of § 1362(f), Company will be treated as an S corporation from d3 to d7, and thereafter, provided that Company's S corporation election is valid and is not otherwise terminated under § 1362(d). Accordingly, Company's shareholders during this period 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 to the shareholders under § 1368.

Except as specifically ruled above, we express or imply no opinion concerning the federal income tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion on whether Company is otherwise qualified to be an S corporation.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Company.

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

Sincerely,
/s/
Christine Ellison
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):
Copy of this letter
Copy for § 6110 purposes
cc :