Internal Revenue Service

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Person To Contact:
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Date:
November 09, 2010

LEGEND

Company =

Subsidiary =

State =

Individual =

Country =

a =

b =

Dear :

We received a letter dated July 2, 2010, and subsequent correspondence, submitted on behalf of Company by its authorized representative requesting a ruling under § 1362(f) of the Internal Revenue Code (Code). This letter responds to that request.

FACTS

Company is a State corporation that elected to be an S corporation effective a. Company wholly owns Subsidiary, a State limited liability company treated as a disregarded entity for federal tax purposes.

Company started an equity incentive plan ("Plan") under which key employees of Company and Subsidiary are awarded participation units entitling the holder to a lump sum payment upon the occurrence of certain events. Under the Plan, if an employee holds a certain number of participation units, the employee is entitled to both cash and Company stock.

On b, one of Subsidiary's employees, Individual, a citizen of Country, became entitled under the Plan to receive cash and Company stock. Before any shares of Company stock were transferred to Individual, however, Company became aware of Individual's ineligibility as a shareholder. Under a shareholders' agreement between Company and its shareholders, Company is prohibited from making any transfer of Company stock that would terminate its S corporation election without certain approval.

Company represents that the circumstances resulting in the possible termination of Company's S corporation election were inadvertent and were not motivated by tax avoidance. Company and its shareholders have agreed to make such adjustments, consistent with the treatment of Company as an S corporation, as may be required by the Service.

LAW AND ANALYSIS

Section 1361(a)(1) provides that for purposes of title 26, 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) provides that for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

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 first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) was terminated under § 1362(d)(2) or (3); (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 such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in 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 such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that Company's S corporation election may have terminated due to an ineligible shareholder. In addition, we conclude that the possible termination was inadvertent within the meaning of § 1362(f). Accordingly, Company will continue to be treated as an S corporation from b, and thereafter, provided Company's S corporation election is not otherwise terminated under § 1362(d). However, this ruling is contingent on Company and its shareholders treating Company as having been an S corporation from b, and thereafter. Accordingly, Company's shareholders must include their pro rata shares of the separately stated and nonseparately computed items of income or loss of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company to shareholders under § 1368.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding whether Company is otherwise eligible to be treated as an S corporation.

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.

Under a power of attorney on file with this office, we are sending a copy of this letter to Company's authorized representative.

Sincerely,

/s/

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
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