Internal Revenue Service

Index Number: 1362.04-00

Department of the Treasury

Washington, DC 20224

199908046

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:3 PLR-117173-98
Date:
November 19, 1998

LEGEND

Company =

Trust =

d1 =

d2 =

d3 =

d4 =

X =

Dear:

This responds to a letter dated August 31, 1998, written on behalf of Company, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, Company was incorporated on d1, and elected to be an S corporation as defined by § 1361(a)(1). On d2, Company issued additional shares of its stock to various persons and entities. One of those entities, the Trust, purchased X shares of Company's stock. The Trust, a charitable remainder unitrust, is an impermissible S corporation shareholder under § 1361(b)(1)(B).

Company's S corporation election terminated under § 1362(d)(2) on d2. Company was not aware of this terminating effect of the transfer of stock to the Trust.

During the period that the Trust held the stock of Company, Company and its shareholders, including the Trust, filed returns treating Company as if it were an S corporation. During this period, Company incurred only losses.

On or about d3, Company's tax attorney learned of the transfer to the Trust and notified Company that Company's S corporation election had terminated. On d4, Company purchased all of the shares that it had transferred to the Trust.

Company represents that it did not intend to terminate its S corporation status and that its actions were not motivated by tax avoidance or retroactive tax planning. The shareholders of Company during the termination period and Company agree to make any adjustments required by the Secretary, consistent with the treatment of Company as an S corporation.

LAW

Section 1361(a)(1) provides that the term "S corporation" means, for 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 that is not an ineligible corporation and that does not 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.

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) the corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the 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 of the corporation at any time during the period specified pursuant to § 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 the ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) of the Income Tax Regulations provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified. In the case of a transfer of stock to an ineligible shareholder that causes an inadvertent termination under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of an S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent any loss of revenue because of the transfer of stock to an ineligible shareholder.

CONCLUSIONS

After applying the relevant law to the facts submitted and the representations made, we conclude that the termination of Company's subchapter S corporation election, as described above, was an inadvertent termination within the meaning of § 1362(f).

Under the provisions of § 1362(f), Company will be treated as continuing to be an S corporation from d2 to d4 and thereafter, assuming Company's S corporation election was valid and was not otherwise terminated under § 1362(d). During the period from d2 until d4, the Trust will be treated as the shareholder of Company.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the foregoing facts. We specifically express no opinion on whether (1) Company otherwise qualifies as an S corporation or (2) the election to treat Company as an S corporation was effective. Furthermore, we express no opinion on the consequences to the Trust of the above transactions under § 664.

Under a power of attorney on file in this office, the original of this letter is being sent to you and a copy is being sent to the taxpayer.

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

Sincerely,

(signed) Jeff Erickson

Jeff Erickson
Assistant to the Branch Chief,
Branch 3
Office of the Assistant Chief
Counsel
(Passthroughs and Special
Industries)

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