INTERNAL REVENUE SERVICE

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October 5, 2000

X =

Y =

A =

B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear

This is in reply to A's letter dated May 17, 2000, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

X was incorporated on Date 1. X elected to be an S corporation effective Date 2. The current shareholders of X are A and B. On Date 3, A and B conveyed their respective interests in X to Y, an ineligible shareholder. The admission of Y as a shareholder resulted in the termination of X's S corporation election. When advised that the admission of Y as a shareholder of X resulted in the termination of X's status as an S corporation, Y transferred its interest in X back to A and B on Date 4.

X was unaware that the admission of Y as a shareholder would terminate X's S corporation election. A, the president of X,represents that neither X nor the shareholders of X intended to terminate X's S corporation election.

A further represents that the terminating event was not part of a plan to terminate X's S election or for tax avoidance purposes. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as 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) provides, in part, that the term "small business corporation" means a domestic corporation which is not an ineligible corporation.

Section 1362(d)(2)(A) provides that an election under § 1361(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) 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 paragraph (2) or (3) of § 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 § 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 submitted and the representations made, we hold that X's election to be an S corporation terminated on Date 3, as a result of the acquisition by Y of stock in X and that the termination was inadvertent within the meaning of § 1362(f).

We further hold that, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 3, to Date 4, and thereafter, provided that X's election to be an S corporation was otherwise valid and was not terminated under § 1362(d). Therefore, the shareholders of X, including Y, must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this letter ruling 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.

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

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

Sincerely yours,
J. THOMAS HINES
Acting Branch Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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