

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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LEGEND

Company =

State =

Shareholders =

LP =

LLC =

a =

b =

c =

d =

e =

f =

g =

h =

Dear _____ :

This letter responds to a letter dated December 6, 2002, and subsequent correspondence, submitted on behalf of Company requesting a ruling under § 1362(f) of the Internal Revenue Code.

According to the information submitted, Company was incorporated in State on a. Company filed an election under § 1362(a) to be treated as an S corporation effective as of b. Company currently has seven shareholders, Shareholders.

On c, one of Company's former shareholders transferred d shares of Company stock to LP, an ineligible shareholder taxable as a partnership. LP is owned equally by four of the current Shareholders. As a consequence of the transfer, Company's S corporation election terminated on c, the date of the transfer of Company stock to LP.

In addition, on e two other current Shareholders, husband and wife, each transferred f shares of Company stock to their respective grantor trusts. The grantor trusts in turn contributed the stock to LLC, an ineligible shareholder.

The termination of Company's S election was discovered shortly thereafter by Company's accounting firm. To correct the terminating event, LP distributed its shares of Company stock to LP's partners on g, and LLC distributed its shares of Company stock to LLC's members on h.

Company represents that the termination of its S corporation election was inadvertent and unintended. In addition, Company and its shareholders agree to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Service.

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 § 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 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 c, when shares of Company's stock were first transferred to an ineligible shareholder, LP. 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 c to h, 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. Also during this period from c to h, the

shares of Company stock held by LP and LLC must be treated as owned by their respective partners and members. If Company or any of Company's shareholders fail to treat Company as described above, this ruling will be null and void.

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's authorized representative.

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

Sincerely yours,

CHRISTINE ELLISON
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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

cc: