

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Date:
March 18, 2011

Legend

- X =
- Y =
- State =
- D1 =
- D2 =
- D3 =
- Trust =
- 1
Trust =
- 2
- A =
- B =

Dear :

This letter responds to a letter dated September 21, 2010, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

Facts

The information submitted states that X was incorporated under the laws of State on D1 and elected to be treated as an S corporation effective D1. Shares of X stock were transferred to Y on D2. Y is a State limited liability company and not an eligible

shareholder of an S corporation under § 1361(b)(1)(B). Therefore, X's S corporation election terminated on D2.

None of X, X's shareholders, Y, or Y's members were aware that Y's ownership of X stock would cause X's S corporation election to terminate. The only members of Y at all times have been Trust 1 and Trust 2. On D3, Y transferred all of its X stock to Trust 2. It is represented that both Trust 1 and Trust 2 are grantor trusts of A and B, respectively, and are eligible S corporation shareholders pursuant to § 1361(c)(2)(A).

X represents that the presence of an ineligible shareholder and the termination of its S corporation election was inadvertent and not motivated by tax avoidance. X further represents that at all times subsequent to D2, X and its shareholders have treated X as an S corporation and the income, deductions, credits and other items of X were reported by A and B just as they would have had no transfers to Y been made. In addition, X and its shareholders agree to make such adjustments, consistent with the treatment of X as an S corporation, as may be required by the Secretary.

Law

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 that 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 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1362(a)(1) 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 1362(d)(2)(A) provides that an election under § 1362(a) will 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(d)(2)(B) provides that the 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) by any corporation 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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based on the facts submitted and representations made, we conclude that X's S corporation election terminated on D2 as a result of the transfer of X stock to Y. We also conclude that the termination of X's status as an S corporation was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2, and thereafter, provided that X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d). Accordingly, X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and non-separately computed items of income or loss 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 by § 1368. If X, or any of the shareholders, fail to treat themselves as described above, this ruling shall be void.

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.

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.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

Sincerely,

Tara P. Volungis
Acting Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

Copy of letter for § 6110 purposes
Copy of letter