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January 14, 1999

X =

Y =

A =

B =

C =

D =

Dear :

This is in reply to a letter dated August 21, 1998, and subsequent correspondence submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

X was incorporated on February 26, 1991. X elected to be an S corporation effective February 26, 1991. The shareholders of X are A, B, C, and D. On July 25, 1995, acting on the recommendations of X's accountants and attorneys, X acquired all the shares of Y, an S corporation, so that Y became a wholly owned subsidiary of X and the S corporation elections of X and Y terminated.

Neither X's attorneys nor X's accountants advised X that the acquisition of the Y stock by X would cause X's S corporation election to terminate.

Early in 1998, a new accountant took over the compliance work for X and Y. During preparation of the corporations' 1997 tax returns, the new accountant discovered the ownership of Y by X.

A, X's president, 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) of the Code 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) of the Code provides, in part, that the term "small business corporation" means a domestic corporation which is not an ineligible corporation.

Section 1361(b)(2)(A) of the Code, as in effect for taxable years beginning on or before December 31, 1996, provided that for purposes of § 1361(b)(1), the term "ineligible corporation" means any corporation which is a member of an affiliated group (determined under § 1504 without regard to the exceptions contained in § 1504(b)). However, effective for taxable years beginning after December 31, 1996, the term ineligible corporation no longer includes a corporation that is a member of an affiliated group.

Section 1362(d)(2)(A) of the Code provides that an election under § 1362(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 small business corporation.

Section 1362(f) of the Code 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 July 25, 1995, as a result of the acquisition by X of 100 percent of the stock of Y. We also hold that the termination was inadvertent within the meaning of § 1362(f) of the Code.

We further hold that, pursuant to the provisions of § 1362(f) of the Code, X will be treated as an S corporation from July 25, 1995 to December 31, 1996, and thereafter, provided that X's election to be an S corporation was otherwise valid and was not terminated under § 1362(d). 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) of the Code 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's authorized representative.

Sincerely yours,

H. GRACE KIM
Assistant to the Chief
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
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