

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

Telephone Number:

Refer Reply To:

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Date:

August 19, 2004

Legend

X =

Y =

A =

State =

d1 =

d2 =

d3 =

Dear

This responds to a letter dated May 21, 2004, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code.

According to the information submitted, X was incorporated under State law on d1 and timely filed an election to be treated as an S corporation, effective d1. On d2, A, the sole shareholder of X, transferred shares of X to Y, an ineligible shareholder, and to others. The transfer of X's shares to Y caused a termination of X's S election. On d3, after learning that the transfer of X stock to Y terminated X's S election, the X stock was transferred to eligible shareholders.

X represents that there was no intention to knowingly terminate the S election and that the events that resulted in the termination were not motivated by tax avoidance or retroactive tax planning. X and its shareholders agree to make any adjustments required by the Secretary 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) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 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 1362(f) provides that if (1) an election under § 1362(a) by any corporation 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, (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 ineffectiveness, steps were taken so that the corporation is once more 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 any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Based solely on the information submitted and the representations made, we conclude that the termination of X's S election was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation from d2 and thereafter provided that X's S election is not otherwise terminated under § 1362(d). A and not Y, will be treated as a shareholder of X for the period from d2 to d3 for those shares that were originally transferred to Y.

Accordingly, all of X's shareholders, in determining their federal tax liability for that period, must include their pro rata share of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X to shareholders as provided in § 1368. This ruling shall be null and void if the requirements of this paragraph are not met.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the above described transaction under any other provision of the Code. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation.

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 a power of attorney on file with this office, copies of this letter are being sent to X's authorized representatives.

Sincerely,

Carolyn Hinchman Gray  
Senior Counsel, Branch 2  
Associate Chief Counsel  
(Passthroughs and Special Industries)

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