Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-110162-05
Date:
June 29, 2005

Legend

X = EIN:

IRA =

A = SSN:

State =

Year 1 =

Date 1 =

Date 2 =

Dear :

This letter responds to a letter dated December 23, 2004, together with subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State in Year 1 and elected to be treated as an S corporation effective in Year 1. On Date 1, X shares were inadvertently issued to IRA, an ineligible shareholder under § 1361(c)(1)(A), rather than to A, an eligible shareholder. X represents that upon discovery of the inadvertent error, it took immediate remedial action and redeemed all the stock issued to IRA on Date 2.

X represents that the transfer of X stock to IRA, an ineligible shareholder, was not motivated by tax avoidance or retroactive tax planning. For all taxable years X's shareholders' income was reported consistent with X qualifying as an S corporation. Furthermore, X and A both treated A as the owner of X stock rather than IRA.

X and all of the relevant shareholders of X agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require.

Section 1361(a)(1) of the Code defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a "small business corporation" cannot have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2) or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under §1362(d)(2) is effective on and after the date of cessation.

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 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 such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the information submitted and the representations made, we conclude that X's S corporation election was terminated on Date 1 when IRA, an ineligible shareholder, acquired X stock. We also conclude that this termination was inadvertent within the meaning of § 1362(f). We further hold that under the provisions of § 1362(f), X will be treated as an S corporation from Date 1, and thereafter, provided that X's S election was valid and was not otherwise terminated.

Accordingly, all of the shareholders of X, in determining their respective income tax liabilities for the period beginning Date 1 and thereafter must include their pro rata share of the separately stated and non-separately computed items of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any

distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

Except as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. Specifically, no opinion is expressed on whether X was otherwise eligible to be treated as an S corporation.

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,

Beverly Katz
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: (2)
2 Copies of this letter
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