Internal Revenue Service

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Department of the Treasury
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-152814-05
Date: January 30, 2006

Legend

X =

IRA #1 =

IRA #2 =

Beneficiary #1 =

Beneficiary #2 =

Shareholders:

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State =

d1 =

d2 =

d3 =

Dear :

This letter responds to your letter dated September 30, 2005, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

X was incorporated under the laws of State on d1. X elected to be an S corporation, effective d1. On d2, X issued stock to IRA #1 and IRA #2, ineligible shareholders under §1361(b)(1)(B) of the Internal Revenue Code. When X issued the shares of stock to the ineligible shareholders, X's S corporation status terminated. X represents that issuance of the stock to the IRA's was an inadvertent error and that the shares in IRA #1 and IRA #2 were transferred to eligible shareholders on d3.

X represents that there was no tax avoidance or retroactive tax planning involved in the transfer of the stock to IRA #1 and IRA #2. For all taxable years X's Shareholders income was reported consistent with X qualifying as an S corporation. In addition, X and the Shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by §1362(f).

Law and Analysis

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other requirements, 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.

Except as provided in § 1362(g), § 1362(a)(1) provides that 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 subsection (a) is 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 any termination under §1362(d)(2)(A) is effective on and after the date of cessation.

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 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 of the corporation at any time during the period specified pursuant to §1362(f), agree to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that for purposes of §1.1362-4(a) the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election was terminated on d2 when IRA #1 and IRA #2, ineligible shareholders, acquired stock in X. We also conclude that the termination was inadvertent within the meaning of §1362(f). Consequently, we conclude that X will

continue to be treated as an S corporation from d2 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated.

This ruling is contingent on X treating Beneficiary #1 as owning the shares of X stock held by IRA #1 and Beneficiary #2 as owning the shares of X stock held by IRA #2, from the period of d2 to d3 and on Shareholders treating X as an S corporation effective d2. Accordingly, Shareholders, in determining their respective income tax liabilities, must include their pro rata share of the separately and nonseperately computed items of X under §1366, make any adjustments to stock basis under §1367, and take into account any distributions made by X under §1368.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

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

Sincerely,

/s/

Christine Ellison
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: