Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
November 1, 2001

Legend

X:

LLC:

IRA1:

IRA2:

D1:

D2:

D3:

D4:

Dear :

This letter responds to your representative's letter dated April 27, 2001, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The represented facts are as follows. X is a corporation that filed an election to be treated as an S corporation under § 1362 for its first taxable year beginning D1. On D2, shares of stock in X were purchased from X by two individual retirement accounts, IRA1 and IRA2. On D3, X's accountants discovered that shares of X had been issued to the IRAs. The accountants advised X that X's S corporation election terminated on D2, when X stock was issued to the IRAs, because IRAs are ineligible S corporation

shareholders. On or before D4, IRA1 and IRA2 each transferred all of the shares of X held by the IRAs to X in exchange for interests in LLC.

X represents that the circumstances resulting in the termination of X's S corporation election on D2 were inadvertent. X represents also that X and its shareholders did not intend to engage in tax avoidance or retroactive tax planning. X and each person who was or is a shareholder of X agree to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

Section 1362(a) 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 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 and other than a trust described in § 1361(c)(2)) 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–(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, such 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 conclude that X's election to be treated as an S corporation was terminated on D2, because ineligible shareholders held shares of X. We also hold that the termination of X's S corporation election was inadvertent within the meaning of § 1362(f). Therefore,

pursuant to § 1362(f), X will be treated as an S corporation from D2, and thereafter, provided that X's subchapter S election is not otherwise terminated under § 1362(d). Accordingly, X's shareholders, in determining their federal tax liability, must include their pro rata share of the separately and nonseparately computed items of X under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by X to shareholders under § 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 or imply no opinion concerning the federal tax consequences of the above-described facts 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, a copy of this letter is being forwarded to X's authorized representative.

Sincerely yours,
Matthew Lay
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
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