Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

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Date:
March 7, 2003

LEGEND

Company =

State =

H1 =

W1 =

H2 =

W2 =

X =

a =

b =

c =

d =

Dear :

This letter responds to a letter dated October 15, 2002, and subsequent correspondence, submitted on behalf of Company requesting a ruling under § 1362(f) of the Internal Revenue Code.

According to the information submitted, Company was incorporated in State in a. From a to b, Company remained inactive. When Company actively began to operate its business, Company filed an election under § 1362(a) to be treated as an S corporation effective as of b. Company's shareholders are X, H1 and W1 and H2 and W2, who each own their stock as community property. However, W1 and W2, shareholders on b, the effective date of the S election, failed to sign the Form 2553, Election by a Small Business Corporation. Therefore, W1 and W2 never consented to Company's election to be an S corporation. Company represents that despite the failure to provide all of the consents necessary for its S election, Company and its shareholders have filed their Federal income tax returns consistent with the treatment of Company as an S corporation.

Prior to c, a revocation of Company's S election was filed with its service center, effective on d. H1 and H2 consented to the revocation of Company's S election. However, W1 and W2, shareholders at the time the revocation was filed, did not consent to the revocation. Company represents that the forms for a revocation were completed in anticipation of a transaction that did not transpire as intended and the revocation was filed inadvertently.

Company also represents that the failure to provide all of the consents for its S corporation election was inadvertent and unintended. In addition, Company and its shareholders agree to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Service.

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 1362(a)(2) provides that an election under § 1362(a) shall be valid only if all persons who are shareholders in the corporation on the day on which the election is made consent to the election.

Section 1.1362-6(a)(2) of the Income Tax Regulations provides that a small business corporation makes an election under § 1362(a) to be an S corporation by filing a completed Form 2553. The election form must be filed with the service center designated in the instructions applicable to Form 2553. The election is not valid unless

all shareholders of the corporation at the time of the election consent to the election in the manner provided in § 1.1362-6(b). However, once a valid election is made, new shareholders need not consent to that election.

Section 1.1362-6(b)(2)(i) provides that when the stock of the corporation is owned by husband and wife as community property (or the income from the stock is community property), or is owned by tenants in common, joint tenants, or tenants by the entirety, each person having a community interest in the stock or income therefrom and each tenant in common, joint tenant and tenant by the entirety must consent to the election.

Section 1362(d)(1) provides that an election under § 1362(a) may be terminated by revocation. An election may be revoked only if shareholders holding more than one-half of the shares of stock of the corporation on the day on which the revocation is made consent to the revocation. Except as provided in § 1362(d)(1)(D), a revocation made during the taxable year and on or before the 15th day of the 3d month thereof shall be effective on the 1st day of the taxable year, and a revocation made during the taxable year but before after the 15th day shall be effective on the 1st day of the following taxable year.

Section 1.1362-6(a)(3)(i) provides, in part, that each shareholder who consents to the revocation must consent in the manner required under § 1.1362-6(b).

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 the ineffectiveness were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness, steps were taken 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 the ineffectiveness, 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 conclude that Company's S corporation election was not effective for the taxable year for which made under § 1362(a)(2), because W1 and W2, whose consent was required, failed to consent to Company's S corporation election. In addition, we conclude that because Company's S election was not effective for the taxable year for which made, the

revocation of Company's S election had no effect under § 1362(d)(1). Moreover, if Company's S election had been effective, the revocation of its election would not be effective because W1 and W2, whose consent was required, failed to consent to the revocation.

We conclude further that the ineffectiveness of Company's S corporation election was inadvertent within the meaning of § 1362(f). Accordingly, under the provisions of § 1362(f), Company will be treated as an S corporation effective b and thereafter, provided that Company's S corporation election was not otherwise invalid and was not otherwise terminated under § 1362(d). Accordingly, Company's shareholders during this period must include their pro rata share of the separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company to the shareholders under § 1368. If Company or any of Company's shareholders fail to treat Company as described above, this ruling will be null and void.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Company.

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

Sincerely yours,

/s/
CHRISTINE ELLISON
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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

cc: