

Internal Revenue Service

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Date:

March 13, 2006

Legend

X =

Y =

A =

State =

D1 =

D2 =

D3 =

Dear

This responds to a letter dated September 15, 2005, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code that the termination of X's S corporation election was inadvertent.

FACTS

According to the information submitted, X was incorporated on D1 pursuant to the laws of State. X elected to be an S corporation effective on D1. On D2, shares of X were transferred to Y, an ineligible shareholder. Also on D2, Y immediately transferred

its stock to eligible shareholders. On D3, X's advisors discovered that Y was an ineligible shareholder. Therefore, X's election to be an S corporation was terminated on D2.

X and its shareholders have agreed to make any adjustments that the Commissioner may require consistent with the treatment of X as an S corporation. A, X's vice president, represents that the circumstances resulting in X's termination as an S corporation were inadvertent. A also represents that X and its shareholders did not intend to engage in tax avoidance or retroactive tax planning.

LAW AND ANALYSIS

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)(B) provides that an S corporation cannot 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.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be 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 the termination shall be effective on and after the date of cessation.

Section 1362(f) provides in relevant part 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 subsection (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 ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, 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 this subsection, 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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely upon the facts submitted and the representations set forth above, we conclude that X's S election terminated on D2. We also conclude that the termination of X's S election constituted an inadvertent termination within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2 and thereafter, provided that X's subchapter S election is not otherwise terminated under § 1362(d).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code.

This ruling is directed only to the taxpayer that 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 sent to X's authorized representative.

Sincerely,

Dianna K. Miosi

Dianna K. Miosi
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
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