Internal Revenue Service

Number: **201247012**
Release Date: 11/23/2012

Index Number: 1362.00-00, 1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-126514-12

Date:
August 02, 2012

X =

Sub =

State =

A =

D1 =

D2 =

D3 =

Dear :

This responds to a letter dated June 18, 2012, and subsequent correspondence submitted on behalf of X by its authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated in State and made an election to be treated as an S corporation effective D1. Also effective D1, X elected to treat Sub as a qualified subchapter S subsidiary (QSub).

X's election was inadvertently invalid on D1 because shares of X stock were owned by an individual retirement account (IRA), an ineligible shareholder under § 1361(c)(2)(A), instead of A.

On or about D2, X learned that its S corporation election was inadvertently invalid. Subsequently, IRA transferred all of its shares of X stock to A, an eligible shareholder under § 1361(b)(1)(B). X represents that A has reported the full amount of income and losses for the shares that IRA owned from D1 through D3.

X represents that its invalid S corporation election was not motivated by tax avoidance or retroactive tax planning. 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.

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, 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.

Rev. Rul. 92-73, 1992-2 C.B. 224, provides that a trust that qualifies as an IRA under § 408(a) is not a permitted shareholder of an S corporation under § 1361.

Section 1361(b)(3)(B) defines a QSub as any domestic corporation which is not an ineligible corporation if 100 percent of the stock of the corporation is held by the S corporation, and the S corporation elects to treat the corporation as a QSub.

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 § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the 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 or termination, the corporation will 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 or invalid election 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 or invalid election was inadvertent. The fact that the terminating event or invalidity of the election was not reasonably within the control of the corporation, and in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination or invalidity of the election 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 or QSub during the period specified by the Commissioner. In the case of stock held by an ineligible shareholder that causes an inadvertent termination or invalid election for an S corporation under § 1362(f), the Commissioner may require protective adjustments that prevent the loss of any revenue due to the holding of stock by an ineligible shareholder (for example, a non-resident alien).

Conclusion

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election was ineffective for the taxable year beginning D1 because the IRA was an ineligible shareholder of X. We conclude that the ineffectiveness of X's S corporation election constituted an inadvertent invalid election within the meaning of § 1362(f). We further conclude that the inadvertent invalid S corporation election does not affect the status of Sub as a QSub.

Under the provisions of § 1362(f), X will be treated as making a valid S corporation election effective from D1 and thereafter, provided that X's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d). In addition, Sub will be treated as a QSub from D1 and thereafter, provided that Sub's QSub election was otherwise valid and has not otherwise terminated.

The shareholders of X, including A, must include their pro-rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as 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 describe above, this ruling is null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code, including whether X was or is a small business corporation under § 1361(b) or whether Sub is otherwise eligible to be a QSub. 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, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Richard Probst
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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