

Internal Revenue Service

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Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-145247-05

Date:

January 26, 2006

Legend

X =

Y =

A =

State =

D1 =

D2 =

D3 =

Dear

This responds to a letter dated August 26, 2005, submitted on behalf of X, requesting relief for an inadvertent invalid subchapter S election under § 1362(f) of the Internal Revenue Code.

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 D1. However, at the time of the S corporation election, a portion of the stock of X was held by Y, an ineligible

shareholder. On D2, Y transferred its shares of X to eligible shareholders. In D3, X's advisors discovered that Y was an ineligible shareholder. Therefore, X's election to be an S corporation was invalid.

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, the president of X, represents that X filed form 1120S, US Income Tax Return for an S corporation, for all the years involved in this request. A represents that the circumstances resulting in X's invalid election to be 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 § 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 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 made, we conclude that X's S election was ineffective for the taxable year beginning on D1. We also conclude that the ineffectiveness of X's S election constituted an inadvertent invalid election within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as an S corporation effective D1 and thereafter, provided that X's election to be an S corporation was not otherwise invalid or 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, including whether X was otherwise eligible to be an S corporation.

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 representatives.

Sincerely,

Audrey W. Ellis

Audrey W. Ellis
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for section 6110 purposes

cc: