

**Internal Revenue Service**

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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:B1

PLR-137485-04

Date:

November 18, 2004

Legend:

X =

Y =

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to the letter dated June 30, 2004, and related correspondence, written on behalf of X, requesting relief for an inadvertent invalid subchapter S election under section 1362(f) of the Internal Revenue Code ("Code").

Facts:

You have represented that the facts are as follows. X is a corporation that made an S corporation election effective Date 1. It was discovered that at the time of the S corporation election, a portion of the stock of X was held by an ineligible shareholder, Y. On or about Date 2, X was informed by its tax advisors of the invalid election. To rectify the situation, the stock owned by Y was transferred to an eligible shareholder on Date 3.

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 section 1362(a) is in effect for the year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual.

Section 1362(d)(2)(A) provides that an election under section 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 that if (1) an election under section 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or (B) was terminated under section 1362(d)(2) or (3), (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 section 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.

Conclusion:

Based upon the information submitted and the representations set forth above, we conclude that X's S election was ineffective for the taxable year beginning on Date 1. We also conclude that the ineffectiveness of X's S election constituted an inadvertent invalid election within the meaning of section 1362(f).

Pursuant to the provisions of section 1362(f), X will be treated as continuing to be an S corporation from Date 1 and thereafter, provided that X's subchapter S election is not otherwise terminated under section 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 the your authorized representative.

Sincerely,

/s/ David R. Haglund

David R. Haglund  
Senior Technician Reviewer, Branch 1  
Office of Associate Chief Counsel  
Passthroughs & Special Industries

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

cc: