

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B01  
PLR-113863-22

Date:  
January 17, 2023

LEGEND

X =

A =

IRA =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year =

\$a =

Dear :

This letter responds to a letter dated July 14, 2022, and subsequent correspondence,

submitted on behalf of X by X's authorized representatives, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

### FACTS

The information submitted states that X was organized under the laws of State on Date 1 and elected to be treated as an S corporation, effective Date 1. As of Date 1, IRA, an individual retirement account for the benefit of A and an ineligible shareholder, held stock of X, thereby making X's S election on Date 1 ineffective. Both A and X were unaware that IRA was an ineligible shareholder. On Date 2, X learned that IRA was an ineligible shareholder of X. On Date 3, IRA distributed its shares in X to A.

X represents that it has filed tax returns consistent with being an S corporation since Date 1. The circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

### LAW AND ANALYSIS

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) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders; (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which a 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 pertinent 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 section 1361(b), or terminated under § 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 event resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation, 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 such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

### CONCLUSION

Based solely on the information submitted and the representations made, we conclude that X's S corporation election was ineffective on Date 1 because IRA was an ineligible shareholder. We further conclude that this ineffectiveness of X's S election was inadvertent within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 1 and thereafter, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d).

As a condition for this ruling, for open taxable years after Year that end prior to Date 3 in which X reported a net loss, IRA will be treated as the shareholder of the shares of stock. For the open tax periods beginning after Year that end prior to Date 3 in which X reported a net gain, A will be treated as the shareholder of the shares of stock. All of X's shareholders in determining their respective income tax liabilities during the termination period and thereafter must include their pro rata share of the separately stated items of income (including tax exempt income), loss, deduction, or credit and non-separately stated computed items of income or loss of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this ruling will be null and void.

This letter ruling is also subject to the following condition: as an adjustment under § 1362(f)(4), X must send a payment of \$a with a copy of this letter to the following address:

Internal Revenue Service  
Kansas City Service Center  
333 W. Pershing Road  
Kansas City, MO 64108  
Stop 7777  
Attn: Manual Deposit

X must send this payment no later than Date 4, 45 days from the date of this letter. If all the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the Kansas City Service Center that its S corporation election has terminated.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representatives.

Sincerely,

Caroline E. Hay

Caroline E. Hay  
Senior Technician Reviewer, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure

Copy for § 6110 purposes

cc: