

Internal Revenue Service

Department of the Treasury

Number: **200215043**
Release Date: 4/12/2002
Index Number: 1362.04-00

Washington, DC 20224

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Refer Reply To:
CC:PSI:2-PLR-138264-01
Date:
January 14, 2002

Legend

X =

Y =

A =

B =

C =

D =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear

This letter responds to a letter dated July 10, 2001, submitted on behalf of X requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that X was formed on Date 1 as a limited liability company that was classified as a partnership for federal tax purposes. X's partners were A and B, individuals, and Y, a corporation. Y was also formed on Date 1. The shareholders of Y were C and D. Y filed an election to be treated as an S corporation, effective Date 1.

X filed a Form 8832, Entity Classification Election, to be classified as an association taxable as a corporation, to be effective on Date 2. Simultaneously, X filed

a Form 2553, Election by a Small Business Corporation, also to be effective on Date 2. However, B and Y did not sign the S election.

On Date 3, A, B, C and D were informed by their advisors that Y's ownership interest in X caused X's S election to be invalid. On Date 4, Y sold its interest in X to C. X represents that as soon as the invalid election was brought to its attention, it took steps to obtain relief. X also represents that there was no intent to knowingly make an invalid S election and that the events that resulted in the invalid election were not motivated by tax avoidance or retroactive tax planning. X's shareholders have consented to the S election and filed the consents with the appropriate service center within a reasonable time upon discovery of the error. Finally, all parties have agreed to make any adjustments that the Secretary 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 the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual.

Section 1362(a)(2) provides that an election under this subsection shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

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 paragraph (2) or (3) of § 1362(d), (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 so that the corporation is a small business corporation; 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 on the facts and the representations submitted, we conclude that X's S election was ineffective, because X had an ineligible shareholder and failed to acquire the consent of all its shareholders at the time of the election. We further conclude that the ineffectiveness was inadvertent within the meaning of § 1362(f). Accordingly, we hold that under the provisions of § 1362(f), X will be treated as an S corporation from Date 2, and thereafter, provided that X's election was otherwise valid and was not terminated under § 1362(d).

This ruling is contingent on X and all of its shareholders treating X as having been an S corporation for the period beginning on Date 2, and thereafter. Accordingly, all of the shareholders in X, in determining their respective income tax liabilities, must include their pro rata share of the separately and nonseparately computed items of X as provided in §1366, make adjustments to stock basis as provided in § 1367, and take into account any distributions made by X as provided by § 1368.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,
Matthew Lay
Senior Technician Reviewer
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2

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