

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3-PLR-146804-01
Date:
May 29, 2002

Legend

Corporation =

Shareholders =

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to a letter dated August 30, 2001, and subsequent correspondence, requesting rulings on behalf of Corporation under § 1362(b)(5) and (f) of the Internal Revenue Code.

Corporation was incorporated on Date 1. Shareholders represent that they intended to elect S corporation status for Corporation effective Date 1. Corporation failed to file timely the election to be treated as an S corporation.

On Date 2, Shareholders entered into an agreement concerning the purchase, financing, and operation of Corporation that inadvertently may have created two classes of stock of Corporation. However, Shareholders represent that the Date 2 agreement was never followed. On Date 3, Shareholders revoked the Date 2 agreement.

Corporation and its shareholders agree to make any adjustments consistent with the treatment of Corporation as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

Corporation requests inadvertent termination relief under § 1362(f) and a ruling that its § 1362(b) election will be treated as timely made for its taxable year that began on Date 1.

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Section 1362(a) generally provides that a small business corporation may elect to be an S corporation for federal tax purposes.

Section 1362(b) provides the rule for when an S election will be effective. Generally, if an election to be treated as an S corporation is made within the first two and one-half months of a corporation's taxable year, then the corporation will be treated as an S corporation beginning in the year in which the election is made. If the election is made after the first two and one-half months of a corporation's taxable year, then the corporation will not be treated as having made an effective election to be treated as an S corporation for federal tax purposes until the following taxable year.

Section 1362(b)(5) provides that if an election to be treated as an S corporation for federal tax purposes is either made untimely, pursuant to § 1362(b), or not made at all, and the Secretary determines that there was reasonable cause for the failure to make a timely election, then the Secretary may treat the corporation as having made a timely election and § 1362(b)(3) will not apply.

Section 1361(b)(1) defines the term "small business corporation" to mean a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate and other than 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 one 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 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 such termination is effective on and after the date the S corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation is 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 was 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 circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation is a small business corporation, or to acquire the required shareholder consents, (4) and 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 or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

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Section 1.1362-4(b) provides that, for purposes of § 1.1362-4(a), the determination of whether a termination 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 was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Based on the facts submitted and representations made, we conclude that Corporation has established reasonable cause for failing to make a timely election pursuant to § 1362(b)(5) and that Corporation is eligible for relief under § 1362(b)(5). Furthermore, we conclude that the execution of the Date 2 agreement would have terminated Corporation's S election, had Corporation timely filed the election. We also conclude that the termination would have been inadvertent within the meaning of § 1362(f). Accordingly, if Corporation makes an election to be treated as an S corporation by filing a completed Form 2553, Election by a Small Business Corporation, with an effective date of Date 1, with the appropriate Service Center within 60 days following the date of this letter, Corporation's election will be treated as timely made for taxable year that begins on Date 1. A copy of this letter should be attached to the Form 2553 filed with the Service Center. A copy is enclosed for that purpose. Pursuant to the provisions of § 1362(f), Corporation will be treated as continuing to be an S corporation from Date 1 and thereafter, provided that Corporation's S election is not otherwise terminated under § 1362(d).

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any provision of the Internal Revenue Code. Specifically, we express or imply no opinion concerning whether Corporation is an S corporation for federal tax purposes.

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.

Sincerely yours,
Christine Ellison, Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: Copy of this letter
Copy for § 6110 purposes

cc: