

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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CC:PSI:B3  
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Date:  
September 24, 2007

Legend

X =

A =

IRA =

State =

a =

\$b =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear :

This responds to a letter dated September 15, 2006, and subsequent correspondence, submitted on behalf of X, requesting inadvertent invalid S corporation election relief pursuant to § 1362(f) of the Internal Revenue Code.

### Facts

X was incorporated under the laws of State on Date 1, first issued shares of stock on Date 2, and elected to be treated as an S corporation effective Date 2.

On Date 2, X issued a shares in the name of the trustee of A's individual retirement account, IRA, in exchange for a contribution of \$b from IRA. IRA is not an eligible shareholder of an S corporation under § 1361(b)(1)(B). Neither X nor X's shareholders were aware that the transfer of stock to IRA would cause X's S corporation election to be invalid.

In Date 3, X learned of the invalidity of X's S corporation election due to the transfer of stock to an ineligible shareholder. In order to correct this, on Date 4, A contributed \$b to IRA in exchange for the a shares of X stock held by IRA. X represents that there was no tax avoidance involved in the inadvertent invalid election. In addition, X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

### Law

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) 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, for purposes of subchapter S, 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 §1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Rev. Rul. 92-73, 1992-2 C.B. 224, provides that a trust that qualifies as an IRA under § 408(a) is not a permitted shareholder of an S corporation under § 1361. In addition, Rev. Rul. 92-73 notes that, when an S corporation inadvertently terminates due to the transfer of S corporation stock to an IRA, relief may be requested pursuant to § 1362(f).

Section 1362(f) provides, in 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 so that the corporation for which the election was made is a small business corporation, or to acquire the required shareholder consents; and (4) the corporation for which the election was made, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of such 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 information submitted and the representations made, we conclude that X's S corporation election was ineffective for the taxable year beginning Date 2 because IRA was an ineligible shareholder. We further conclude that the ineffectiveness of X's S corporation election constituted an inadvertent invalid election within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 2 and thereafter, provided that X's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d).

As a condition for this ruling, for the tax periods from Date 2 to Date 4, in which X reported a net loss, IRA will be treated as the shareholder of the a shares of stock. Otherwise, A must be treated as the shareholder of the a shares of stock for the tax periods from Date 2 to Date 4. Accordingly, all shareholders of X must include the pro rata share of the separately and nonseparately computed items attributable to those shares in their income as provided in § 1366, make adjustments to the stock basis of those shares as provided in § 1367, and take into account any distributions with respect to those shares as provided in § 1368. If X or its shareholders fail to treat X as described above, this ruling will be null and void.

Except as specifically ruled above, no opinion is expressed or implied concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation.

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

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

/s/

Tara P. Volungis  
Senior Technician Reviewer, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

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