



The information submitted states that X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation, effective Date 2. On Date 3, X issued shares of X to an individual retirement account (IRA), an ineligible shareholder, for the benefit of A, thereby terminating X's S election on Date 3. Both A and X were unaware that the transfer caused a termination. X and all its shareholders continued to treat X as an S corporation. On Date 4, X's counsel informed X that the IRA was an ineligible shareholder of X. On Date 5, the IRA distributed its shares in X to A.

The period of limitations on assessments under § 6501(a) has expired for the taxable years ending before Date 6. However, the period of limitations on assessments under § 6501(a) has not expired for the taxable years beginning on Date 6, or for any subsequent years.

X represents that 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.

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)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that 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.

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 that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in the ineffectiveness, 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 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, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the information submitted and the representations made, we conclude that X's S corporation election terminated on Date 3, under § 1362(d)(2), because of the transfer of shares of X to an ineligible shareholder, and that this termination of X's S election was an inadvertent termination within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 6 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 the tax periods beginning on or after Date 6 in which X reported a net loss, IRA will be treated as the shareholder of the shares of stock. For the tax periods beginning on or after Date 6 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.

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.

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

Sincerely,

Melissa C. Liquerman  
Senior Technician Reviewer, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

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