

shares it had transferred to IRA to A, an individual and an eligible S corporation shareholder.

X represents that the transfer X of stock to IRA, an ineligible shareholder, was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have continued to treat X as an S corporation at all times. X and its shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require.

Section 1361(a)(1) of the Code defines an “S corporation” as a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a “small business corporation” cannot 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.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

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 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 (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 or termination, 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, when X agreed to transfer X stock to IRA, an ineligible shareholder. We also conclude that this termination was inadvertent within the meaning of § 1362(f), and that under the provisions of § 1362(f), X will be treated as an S corporation from Date 3, and thereafter, provided that X's S election was valid and was not otherwise terminated.

As a condition for this ruling, for any tax periods beginning on or after Date 3 in which X reported a net loss, IRA will be treated as the shareholder of the shares of stock at issue. For any tax periods beginning on or after Date 3 in which X reported a net gain, A will be treated as the shareholder of the shares of stock at issue. 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 themselves as described above, this ruling shall be null and void.

Except as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. Specifically, no opinion is expressed on whether X was 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 the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: (2)

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