

Therefore, X's S corporation election terminated on D2. About D3, X learned of the termination of X's S corporation election due to the transfer of stock to an ineligible shareholder. In order to correct this problem, effective D4, Y distributed its X shares to A and B consistent with their X ownership prior to their D2 transfer of X stock to Y.

X represents that the circumstances resulting in X's invalid S corporation election were inadvertent and not motivated by tax avoidance or retroactive tax planning. X further represents that X has filed returns consistent with X's status as an S corporation. 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(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which it was 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 § 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 event resulting in the 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 facts submitted and the representations made, we conclude that X's S corporation election was terminated on D2 because Y was not an eligible shareholder of X. We also conclude that the termination of X's S election on D2 was inadvertent within the meaning of § 1362(f). Therefore, we conclude that X will be treated as an S corporation from D2 and thereafter, provided that X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d).

This ruling is conditioned upon the shareholders of X including in income their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, making any adjustments to basis as provided in § 1367, and taking into account any distributions made by X as provided by § 1368.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed regarding X's eligibility to be 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 sent to X's authorized representative.

Sincerely,

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

Enclosures (2)
Copy of this letter
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cc: