

Internal Revenue Service

Number: **201205002**
Release Date: 2/3/2012

Index Number: 1361.01-02, 1362.00-00,
1362.01-00, 1362.02-00, 1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-122225-11
Date:
October 12, 2011

Legend:

X =

A =

B =

C =

D =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear _____ :

This responds to a letter dated May 13, 2011, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was originally formed as an LLC on Date 1, under the laws of State. X filed both Form 8832, Entity Classification Election, to elect to be classified as an association taxable as a corporation, and Form 2553, Election by a Small Business Corporation, to be treated as an S corporation effective on Date 2.

On Date 3, B, a shareholder of X became an ineligible shareholder. On Date 4, it became known that B was an ineligible shareholder and on Date 5, the X stock held by B was distributed to C and D.

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 Service

LAW AND ANALYSIS

Section 1361(a)(1) 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, 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 taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of cessation.
' 1362(d)(2)(B).

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 consent, 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 circumstances resulting in the 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 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 termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's election to be treated as an S corporation terminated on Date 3, when B became an ineligible S corporation shareholder. We also conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f). X will be treated as continuing to be an S corporation from Date 3, and thereafter, provided that X's S corporation election is not otherwise terminated under § 1362(d). This ruling is contingent upon X and its shareholders treating C and D as the shareholders of the X stock held by B as of Date 3; and upon X and all its shareholders treating X as having been an S corporation as of Date 2, and thereafter.

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 computed items of income or loss of X as provided in ' 1366, make any adjustments to basis as provided in ' 1367, and take into account any distributions made by X as provided by ' 1368. If X, or any of the shareholders, fails to treat themselves as described above, this ruling shall be void.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code, including whether X was otherwise a valid 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 will be sent to X's authorized representative.

Sincerely,

Faith P. Colson

Faith P. Colson

Senior Counsel, Branch 1

Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures:

Copy of this letter

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