

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Person To Contact:

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PLR-106705-15

Date:

July 20, 2015

X =

State =

A =

B =

C =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Dear :

This letter responds to a letter dated January 29, 2015, and subsequent correspondence, written on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

Facts

The information submitted states that X, a newly-formed State limited liability company, elected to be an S corporation effective Date 1. Some interest holders of X, however, failed to properly consent to X's S corporation election. Therefore, X's S corporation election was ineffective. In addition, on Date 2, Date 3 and Date 4, interests in X were issued to individual retirement accounts ("IRAs") A, B and C, ineligible S corporation shareholders under § 1361(b)(1)(B). Consequently, had X's S corporation election been effective on Date 1, X's S corporation election would have terminated on Date 2. In Date 5, X learned that A, B and C were ineligible S corporation shareholders. Subsequently, by Date 6, X redeemed A's, B's and C's interests in X.

X represents that it always intended to maintain its S corporation status and that the failure of all the shareholders of X to properly consent to X's S corporation election and the termination of X's S corporation election were inadvertent and did not involve retroactive tax planning or tax avoidance. X further represents that X and its shareholders have always treated X as an S corporation and 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 and Analysis

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) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Rev. Rul. 92-73, 1992-2 C.B. 224, holds that a trust that qualifies as an individual retirement account under § 408(a) is not a permitted S corporation shareholder under § 1361.

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect to be an S corporation.

Section 1362(a)(2) provides that an election under § 1362(a) shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1.1362-6(b)(1) of the Income Tax Regulations provides that, except as provided in § 1.1362-6(b)(3)(iii), the election of the corporation is not valid if any required consent is not filed in accordance with the rules contained in § 1.1362-6(b).

Section 301.7701-3(c)(1)(v)(C) of the Procedure and Administration Regulations provides that an eligible entity that timely elects to be an S corporation under § 1362(a)(1) is treated as having made an election under § 301.7701-3 to be classified as an association, provided that (as of the effective date of the election under § 1362(a)(1)) the entity meets all other requirements to qualify as a small business corporation under § 1361(b).

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

Section 1362(f) provides, in part, 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 circumstances 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.

Section 1.1362-4(d) provides, in part, that in the case of stock held by an ineligible shareholder that causes an inadvertent termination for an S corporation under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a

shareholder of the S corporation during the period the ineligible shareholder actually held stock in the corporation.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election was ineffective on Date 1 as a result of the failure of some interest holders of X to consent to X's S corporation election. We further conclude that the ineffectiveness of X's S corporation election constituted an inadvertent invalid election within the meaning of § 1362(f). In addition, because interests in X were transferred to A, B and C, ineligible S corporation shareholders, on Date 2 we conclude that X's S corporation election would have terminated on Date 2 had X's S corporation election been effective on Date 1. We further conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as an S corporation on and after Date 1, provided that X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d).

For any tax periods between Date 2 and Date 6 in which X reported a net loss, shareholders who were IRAs will be treated as the shareholders with respect to the interests in X held by them at that time. For any tax periods between Date 2 and Date 6 in which X reported a net gain, the beneficiaries of the IRAs will be treated as the shareholders with respect to the interests in X held by the IRAs.

In addition, as a condition to the ruling, all members of X that held interests in X on Date 1 and that did not properly consent to X's S corporation election must sign a written statement as described in § 1.1362-6(b)(1) consenting to X's S corporation election effective Date 1. The written statement(s) must be filed with the appropriate service center within 120 days from the date of this letter, indicating that the statement(s) are to be associated with X's originally filed Form 2553, Election by a Small Business Corporation.

Except as specifically set forth above, we express or imply no opinion as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, we express or imply no opinion as to whether X is otherwise eligible to be an S corporation.

This ruling is directed only to the taxpayer that 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, we are sending a copy of this letter ruling to X's authorized representatives.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed

by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

A copy of this letter
A copy for § 6110 purposes

cc: