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Person To Contact:

ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-103519-18

Date:

February 25, 2019

LEGEND

X =

Y =

A =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear _____ :

This responds to a letter dated October 25, 2017, and supplemental correspondence, submitted on behalf of X, by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

Facts

According to the information submitted and representations made within, X was formed under the laws of State and made an S election effective Date 1. On Date 2, all of the shares in X were transferred to Y, a disregarded entity wholly owned by A, an eligible S corporation shareholder. On Date 3, Y became a partnership for federal tax purposes. Y, as a partnership, was an ineligible shareholder of an S corporation. On Date 4, X discovered that Y was an ineligible shareholder that caused X's S election to terminate effective Date 3. On Date 4, X and its shareholders took remedial action by having Y transfer all of its shares in X to A, an eligible S corporation shareholder. After Date 4, all income and other items from the X shares were allocated to A.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and not motivated by tax avoidance or retroactive tax planning. X further represents that it has filed returns consistent with its status as an S corporation. X and its shareholders have agreed to make any adjustments the Commissioner may require, consistent with the treatment of X as an S corporation.

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 the year. Section 1361(b)(1) defines a "small business corporation" as 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 1 class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under subsection (a) or section 1361(b)(3)(B)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to subsection (b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of subsection (d) or section 1361(b)(3)(C); (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 for which the election was made or the

termination occurred is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or (B) to acquire the required shareholder consents; and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation or a qualified subchapter S subsidiary, as the case may be during the period specified by the Secretary.

Conclusion

Based solely on the information submitted and the representations made, we conclude that X's S election terminated on Date 3 because X had an ineligible shareholder. We further conclude that the termination was inadvertent within the meaning of § 1362(f).

Accordingly, under § 1362(f), X will be treated as continuing to be an S corporation on and after Date 3, provided that X's S corporation election was valid and not otherwise terminated under § 1362(d).

Y will be treated as the shareholder of X from Date 2 until Date 4, at which point A will be treated as the shareholder. Accordingly, the shareholders of X must include in income their pro rata share of the separately stated and nonseparately computed items 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 in § 1368.

Except as specifically ruled above, we express or imply no opinion as to the federal income tax consequences of the facts described above under any other provision of the code, including whether X was otherwise a valid S corporation.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

Sincerely,

David R. Haglund

David R. Haglund
Branch Chief, Branch 1
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for section 6110 purposes