



Year 4 =

Dear :

This letter responds to a letter dated November 4, 2021, and subsequent correspondence, submitted on behalf of Company by its authorized representative requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

### **FACTS**

The information submitted states Company was incorporated on Date 1, under the laws of State. The Company shareholders filed Form 2553, Election by a Small Business Corporation, for Company to be an association treated as an S corporation effective Date 2. X was an organization described in § 501(c)(3) and a shareholder of Company on Date 2. Pursuant to Letter, X's § 501(c)(3) status was retroactively converted to § 501(c)(4) status, effective Date 3. Accordingly, the S corporation election for Company terminated, effective Date 3, because X became an ineligible S corporation shareholder. Upon discovering X's status as an ineligible shareholder, Company transferred shares of stock owned by X to Y, an eligible shareholder, effective Date 4.

Company represents that the circumstances resulting in the termination of Company's S corporation election were inadvertent and not motivated by tax avoidance or retroactive tax planning. Company further represents that X has filed its Exempt Organization Business Tax Returns on Form 990-T for tax years Year 1, Year 2, Year 3 and Year 4, and has paid its unrelated business income tax reported in those returns. Company, its shareholders, and X have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of Company as an S corporation.

### **LAW AND ANALYSIS**

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

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.

Section 1361(c)(6) provides that certain exempt organizations are permitted as shareholders, that is, an organization which is (A) described in § 401(a) or 501(c)(3), and (B) exempt from taxation under § 501(a).

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 1st 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 § 1362(a) by any corporation 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, (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in the ineffectiveness, 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, the corporation shall be treated as an S corporation during the period specified by the Secretary.

### **CONCLUSION**

Based on the facts submitted and representations made, we conclude that Company's S election, effective Date 2, was terminated on Date 3. The S election for Company was terminated because X, an ineligible shareholder, held Company shares.

We conclude the termination of Company's S election was inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), Company will be treated as an S corporation from Date 3, and thereafter, provided Company's S election is otherwise valid and has not terminated under § 1362(d).

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether Company 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 this ruling may not be used or cited as precedent.

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.

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

Sincerely,

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Richard T. Probst  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure:

Copy of letter for § 6110 purposes

cc: