

Internal Revenue Service

Department of the Treasury

Number: **200144023**
Release Date: 11/2/2001
Index Number: 1362.01-03

Washington, DC 20224

Person to Contact:

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CC:PSI:Br.1 - PLR-135645-01

Date:

August 06, 2001

Legend:

- X =
- Y =
- Z =
- State =
- D1 =
- D2 =
- D3 =
- D4 =
- n =

This responds to your letter dated June 27, 2001, submitted on behalf of X requesting relief under section 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that X incorporated under the laws of State on D1. On D2, X filed its Form 2553 to elect to be an S corporation effective D3. However, the S corporation election was ineffective because Y, a shareholder of X as of D3, was an ineligible shareholder. It had been intended that Y would transfer its shares to a trust, Z, an eligible shareholder under § 1361(c)(2)(A)(i) prior to D3. However, the transfer did not take place until D4. In addition, while preparing this ruling request, X discovered that the trustees of n family trusts signed the shareholder's consents as trustees rather than as deemed owners. It is represented that the n family trusts are eligible shareholders under § 1361(c)(2)(A)(i).

LAW AND ANALYSIS

Section 1361(a) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1) of the Code defines the term "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an

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estate, a trust described in subsection (c)(2), or an organization described in subsection (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(f) of the Code provides, in part, that, if (1) an election under section 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361(b), (2) the Secretary determines that the circumstances resulting in the ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to section 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 the ineffectiveness, the corporation will 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 was ineligible to be an S corporation as of D3. We also conclude that the circumstances resulting in the ineffectiveness were inadvertent. Moreover, the improper execution of the shareholder's consents by the n family trust was inadvertent. Therefore, X will be treated as an S corporation effective D3 and thereafter, provided that X's S corporation election is not otherwise terminated. During the period D3 to D4, Z will be treated as if it owned the shares of X held by Y.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

Sincerely,
/s/ David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

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