

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
August 7, 2001

Company =
A =
B =
X =
Date 1 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =

Dear

This letter responds to your letter dated February 20, 2001, and subsequent correspondence submitted on behalf of Company, requesting inadvertent invalid election relief under section 1362(f) of the Internal Revenue Code.

FACTS

Company was formed on Date 1 for the purpose of acquiring the stock of X. From Year 1 through Year 2, Company filed consolidated returns and included X as its wholly owned subsidiary. In Year 3, Company filed a Form 2553 with the Internal Revenue Service Center to be an S corporation under §1362(a). In Year 3, however, a corporation that was a member of an affiliated group was an ineligible corporation under §1361(b)(2)(A). As a result, Company's S election was invalid.

In Year 4, Company retained the services of an attorney with regard to Company's anticipated activities. It became apparent that Company's S election was invalid due to its status as a member of an affiliated group. Thereafter, Company submitted this ruling request. It is represented that the existence of an ineligible shareholder was inadvertent and not the result of retroactive tax planning.

From its formation in Year 1 through the present, Company had two

shareholders (A and B). Since Year 1, the income and expenses of X have been reported on Form 1120S filed by Company and have been included in A and B's individual income tax returns. Company and each of its shareholders agree to make such adjustments or take such action (consistent with the treatment of Company as a S Corporation) as may be required by the Secretary with respect to the tax period in issue.

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) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation.

For taxable years beginning on or before December 31, 1996, §1361(b)(2)(A) provided that for purposes of §1361(b)(1), the term "ineligible corporation" meant any corporation that was a member of an affiliated group (determined under §1504 without regard to the exceptions contained in §1504(b)). However, for taxable years beginning after December 31, 1996, the term "ineligible corporation" no longer includes a corporation that is a member of an affiliated group.

Section 1362(a) provides that a small business corporation may elect to be an S corporation.

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 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 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 so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified agrees to make adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the termination period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSIONS

Based on the facts submitted and representations made, we conclude that Company's S corporation election was ineffective or terminated inadvertently and that corrective steps were taken within a reasonable period after the discovery of the circumstances resulting in the ineffectiveness or termination. Under §1362(f), Company will be treated as if it were an S corporation from Date 1 and thereafter, provided Company's S corporation election was otherwise valid and not otherwise terminated under §1362(d).

This ruling is contingent on Company and all of its shareholders treating Company as having been an S corporation for Year 1, and thereafter. Accordingly, Company's shareholders, in determining their respective income tax liabilities for the period beginning Year 1, and thereafter, must include their pro rata share of the separately and nonseparately computed items of Company under §1366. If Company or its shareholders fail to treat Company as described above, this ruling shall be null and void.

A copy of this letter must be attached to any income tax return for which it is relevant.

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

Under a Power of Attorney on file with this office, we are sending a copy of this letter to the taxpayer.

Sincerely,
Christine Ellison
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes