Internal Revenue Service

Department of the Treasury

Index Number: 1362.02-02

Washington, DC 20224

Person to Contact:

Telephone Number:

Number: **199931010**
Release Date: 8/6/1999

Refer Reply To:
CC:DOM:P&SI:3 / PLR-107338-99
Date:
May 4, 1999

LEGEND

Company =

State =

Date1 =

Date2 =

Date3 =

Date4 =

A =

B =

C =

X =

Dear

This letter responds to a letter dated April 2,1999, submitted on behalf of Company, requesting relief under § 1362(f) of the Internal Revenue Code.

According to the information submitted, Company was incorporated on Date1 in State. At the time of incorporation, A was Company's sole shareholder. Company filed an election to be treated as an S corporation for its X taxable year.

On Date2, A transferred Company stock to B, an individual retirement account (IRA) of C. On Date3, Company's accountants advised A that an IRA is an ineligible S corporation shareholder. Thus, the transfer of stock to B terminated Company's S election. On approximately Date4, B distributed the Company stock to C in a specific asset distribution.

Company and each of its shareholders who were shareholders during the period of invalidity agree to make any adjustments consistent with the treatment of Company as an S corporation.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not 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.

Revenue Ruling 92-73, 1992-2 C.B. 224, holds that a trust qualified as an individual retirement account under § 408 is not a permitted shareholder of an S corporation under § 1361.

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

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, 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 under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

After applying the relevant law to the facts submitted and the representations made, we conclude that Company's S corporation election terminated on Date2 when

B, an ineligible S corporation shareholder, acquired Company stock. We also conclude that the termination was inadvertent within the meaning of § 1362(f).

Under the provisions of § 1362(f), Company will be treated as continuing to be an S corporation during the period from Date2 to Date4, and thereafter, provided that Company's S corporation election was not otherwise invalid and provided that the election was not otherwise terminated under § 1362(d). Additionally, during the period from Date2 to Date4, C will be treated as the owner of the Company stock held by B. Accordingly, C must include his pro rata share of the separately and nonseparately computed items of Company as provided in § 1366. If Company or any of its shareholders fail to treat Company as described above, this ruling shall be null and void.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether Company is otherwise qualified to be an S corporation.

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

Under the power of attorney on file with this office, this letter is being sent to Company's authorized representative. A copy of this letter is being sent to Company.

Sincerely yours,

Jeff Erickson
Assistant to the Chief, Branch 3
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

enclosure:
copy for § 6110 purposes