

Internal Revenue Service

Number: **200522007**

Release Date: 6/3/2005

Index Number: 1362.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:PSI:B03

PLR-139061-04

Date:

February 28, 2005

LEGEND

X =

Y =

State =

A =

B =

C =

D =

E =

D1 =

D2 =

D3 =

Dear _____ :

This letter responds to a letter, dated July 16, 2004, on behalf of X from X's authorized representative, requesting inadvertent invalid election relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State on D1, and timely filed a Form 2553, Election by a Small Business Corporation, effective D2. X's S corporation election was accepted by the Service Center. When X filed its Form 2553, X's shareholders were A, B, and C, all of whom were individuals, and Y, an S corporation. The shareholders of Y were D and E, both individuals. Y, as an S corporation, was an ineligible shareholder of another S corporation that was not a qualified subchapter S subsidiary. In D3, X was advised by its new legal counsel that Y was an ineligible shareholder of an S corporation and that X's S corporation election was ineffective. Y distributed its shares of X to E and F, and X filed for a private letter ruling.

From D2, onward, X represents that it filed its tax returns as if it were an S corporation. This includes allocating its items of income, loss, deduction, and credit to all of its shareholders, including Y. Y in turn, allocated those items to its shareholders, D and E. X represents that the amount of tax paid during this period was the same as if D and E would have held the stock in X directly, or differs by a de minimis amount.

X requests a ruling that its invalid S corporation election was inadvertent within the meaning of § 1362(f)

LAW AND ANALYSIS

Section 1361(a) 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)(B) provides the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which 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.

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

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made by reason of a failure to meet the requirements of § 1361(b), (2) the Secretary determines that the circumstances resulting in such ineffectiveness was inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, 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 pursuant to § 1362(f), 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 such period, then, notwithstanding the circumstances resulting in such ineffectiveness, such corporation shall be treated as any S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's S election was ineffective for the taxable year beginning on D2 because Y was an ineligible shareholder of X. We further conclude that the ineffectiveness of X's S election constituted an inadvertent invalid election within the meaning of § 1362(f).

Under the provisions of § 1362(f), X will be treated as an S corporation from D2, and thereafter, provided that, apart from the inadvertent invalid election ruling above, X's S election was otherwise valid and has not otherwise terminated under § 1362(d). This ruling is contingent upon X and all its shareholders treating X as having been an S corporation for the period beginning D2, and thereafter. This letter is further contingent upon the shareholders of X adjusting their bases and accumulated adjustment accounts to make up for any discrepancies that occurred when Y held X stock.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed regarding whether X is otherwise eligible to be an S corporation.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being mailed to X's authorized representatives.

Sincerely yours,

/s/

Jeanne Sullivan
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes

cc: