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Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:1-PLR 113284-98
Date:
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Legend

X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year1 =

Year2 =

Year3 =

State =

This responds to a letter submitted on behalf of X requesting relief under § 1362(f) of the Internal Revenue Code.

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FACTS

X was incorporated in State on Date 1 and made a timely election to be treated as an S corporation effective Date 2. The election to be treated as an S corporation was invalid, however, because certain of the shareholders did not consent. All of the shareholders of X have now consented to the election. On Dates 3 and 4, shares in X were transferred to a trust that was an ineligible shareholder of an S corporation. Those shares have now been distributed to an eligible shareholder. In Year1 and Year2, unequal cash distributions were made in error to the shareholders of X. In Year3, the corporation took corrective action to equalize the distributions to the shareholders, taking into account the prior unequal distributions. All of the shareholders of X have consented to any adjustments (consistent with the treatment of X as an S corporation) as may be required.

LAW AND ANALYSIS

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

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate and other than a trust described in subsection (c)(2)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1362(a)(2) provides that an election to be treated as an S corporation shall be valid only if all persons who are shareholders in such corporation on the day which such election is made consent to such election.

Section 1362(d)(2) provides that an election to be an S corporation shall be terminated whenever 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 by reason of a failure to meet the requirements of section 1361(b) or was terminated under section 1362(d)(2), (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, 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 of inadvertent ineffectiveness of the S election, 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 is treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the representations made, we conclude that X was ineligible to elect to be an S corporation as of Date 2. We also conclude that the circumstances resulting in the ineffectiveness of X's S election were inadvertent. In addition, we conclude that the circumstances which would have subsequently terminated X's election were inadvertent. Therefore, X will be treated as an S corporation effective Date 2 and thereafter, provided X's S corporation election is not otherwise terminated, provided each of the current shareholders of X is a qualified shareholder by the date which is 60 days after the date of this letter, and provided the shareholders of X make any required adjustments.

Except as specifically set forth above, no opinion is expressed or implied as to the federal income tax consequences of the transaction described under any other provision of the Code. In particular, no opinion is expressed as to whether X made an otherwise valid subchapter S election under section 1362 or whether X's S election was otherwise terminated.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. As provided by a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

DAVID R. HAGLUND
Senior Technician Reviewer, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
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