Internal Revenue Service

Number: **201202003**
Release Date: 1/13/2012

Index Number: 1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-112370-11
Date:
September 15, 2011

Legend:

X =

State =

A =

B =

D1 =

D2 =

Partnership 1 =

Y =

Partnership 2 =

Z =

Dear :

This responds to the letter dated March 23, 2011, and related correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code ("Code") for an inadvertent termination of S election.

FACTS

The information submitted states that X was incorporated under the laws of State. A and B, both individuals, were equal shareholders of X. X elected to be treated as an S corporation, effective D1. On D2, A transferred A's stock in X to Partnership 1 in exchange for a limited partnership interest in Partnership 1. A and B's two children were also nominal partners of Partnership 1. Y, an S corporation wholly owned by A, was the general partner of Partnership 1.

Also on D2, B transferred B's stock in X to Partnership 2 in exchange for a limited partnership interest in Partnership 2. A and B's two children were also nominal partners of Partnership 2. Z, an S corporation wholly owned by B, was the general partner of Partnership 2.

X and its shareholders were unaware of the fact that Partnership 1 and Partnership 2 were ineligible shareholders and did not intend the S election of X to terminate. The income of X has been consistently allocated to A and B as though they held their interests in X directly.

Immediately after the discovery of the error, X and its shareholders took remedial action by having A and B's children transfer their interests in Partnership 1 and Partnership 2 to A and B, respectively. In addition, both Y and Z converted to limited liability companies (LLCs) under state law. X, Y, Partnership 1, and Partnership 2 have not elected under § 301.7701-3 of the Procedure and Administration Regulations to be treated as associations taxable as corporations. As such, the shareholders of X were again eligible shareholders. Additionally, X and its shareholders agree to make any adjustments required consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

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 cannot 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(d)(2)(A) provides that an election under §1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1362(f) provides in part that if (1) an election under § 1362(a) by any corporation (A) 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 consent, or (B) was terminated under § 1362(d)(2) or (3), (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 the ineffectiveness or termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, 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 such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely upon the facts submitted and the representations made, we conclude that X's S election terminated on D2. We further conclude that the termination of X's S election constituted an inadvertent termination within the meaning of § 1362(f).

Under § 1362(f), X will be treated as an S corporation from D2, and thereafter, provided that 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. In addition, if the conversion of Y and Z to LLCs resulted in taxable distributions, this ruling is also contingent upon A and B properly reporting such distributions on their respective individual income tax returns.

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the facts described above under any other provision of the Code.

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.

In accordance with the Power of Attorney on file with this office, copies of this letter ruling will be sent to your authorized representatives.

Sincerely,

Joy C. Spies
Joy C. Spies
Acting Senior Technician Reviewer
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes

cc: