

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Legend

Taxpayer =  
  
Month 1 =  
  
Taxable Year 1 =  
  
Taxable Year 2 =

Dear

This letter responds to a letter dated July 6, 1999, written on behalf of Taxpayer, requesting relief under § 1362(f) of the Internal Revenue Code from Taxpayer's invalid S corporation election.

**FACTS**

According to the information submitted, Taxpayer is a domestic corporation that in Month 1 elected S corporation status under § 1362(a). Taxpayer filed timely returns as an S corporation for Taxable Years 1 and 2.

From the time Taxpayer elected S corporation status until present, two of Taxpayer's shareholders have been non-resident aliens ("NRAs").

At the time of Taxpayer's election, Taxpayer was unaware that non-resident aliens could not be shareholders of an S corporation.

Taxpayer requests § 1362(f) relief for its invalid § 1362(a) election. Toward that

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end, Taxpayer proposes the following remedial measures. The NRA shareholders will transfer their stock to X who is an eligible shareholder. Taxpayer will amend its Year 1 and Year 2 returns to allocate X all income that was allocated to the NRA shareholders.

The NRA shareholders represent that they will transfer their shares of Taxpayer to X, and X represents that it will amend its returns for Years 1 and 2 to take into account the income that was allocated to the NRA shareholders.

### **Discussion**

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 such year. Section 1361(b)(1)(C) provides that a domestic corporation cannot be a “small business corporation” if the corporation has a NRA as a shareholder.

Because Taxpayer had NRAs as shareholders when Taxpayer elected under § 1362(a), Taxpayer was not a small business corporation in Month 1. As such, Taxpayer was not eligible to elect under § 1362(a) and the election was ineffective.

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, (2) the Secretary determines that the circumstances resulting in such ineffectiveness 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 in the corporation at any time during the period specified pursuant to § 1362(f), 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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

### **Conclusion**

After applying the relevant law and regulations to the representations made, we conclude as follows. Notwithstanding the ineffectiveness of Taxpayer’s S corporation election because of Taxpayer’s failure to comply with § 1361(b)(1)(C), Taxpayer will be treated as an S corporation from the time of the election and thereafter, provided the election was otherwise effective and was not terminated under § 1362(d).

This ruling is conditioned on the following. The NRA shareholders must transfer all their shares in Taxpayer to X. From the time of Taxpayer’s election and thereafter, X must, in determining its federal income tax liability, take into account the NRA shareholders’ pro rata share of the separately and nonseparately computed items of Taxpayer as provided in § 1366, make any adjustments to stock basis as provided in

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§ 1367, and take into account any distributions made by Taxpayer as provided in § 1368. If Taxpayer, the NRA shareholders, or X fail to comply with these conditions, this ruling will be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code.

This letter is issued only to the taxpayer who requested it. Under § 6110(k)(3), it may be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter will be sent to Taxpayer's authorized representative. Taxpayer should attach a copy of this letter to its next federal income tax return. We enclose a copy for that purpose.

Sincerely yours,

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

encl: copy for § 6110 purposes