



D2. On D3, Y transferred its shares of X to Trust 1 and Trust 2, each of which is a permitted shareholder under § 1361(c)(2)(A)(i).

A represents that the termination of X's S corporation election on D2 was inadvertent. Additionally, A represents that X and its shareholders did not intend to engage in tax avoidance or retroactive tax planning. X and each person who was or is a shareholder of X agree to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

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

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)(B) provides that 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(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1<sup>st</sup> day of the 1<sup>st</sup> taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides 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 consents, 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 such 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 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 or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we conclude that X's election was terminated on D2 because an ineligible shareholder held shares of X. Additionally, we conclude that the termination of X's S election was inadvertent within the meaning of § 1362(f).

Further, we conclude that under the provisions of § 1362(f), X will be treated as an S corporation effective D2 and thereafter, provided X's election to be an S corporation was not otherwise invalid and provided that the election was not otherwise terminated under § 1362(d). Accordingly, X's shareholders, in determining their federal tax liability, must include their pro rata share of the separately and nonseparately computed items of X under § 1367, and take into account any distributions made by X to shareholders under § 1368. If X or its shareholders fail to treat X as described above, this ruling shall be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transaction described above under any other provision of the Code. Specifically, no opinion is expressed on whether X was or is otherwise a valid S corporation.

This ruling letter 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.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Beverly Katz  
Senior Technician Reviewer, Branch 2  
Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes

cc: