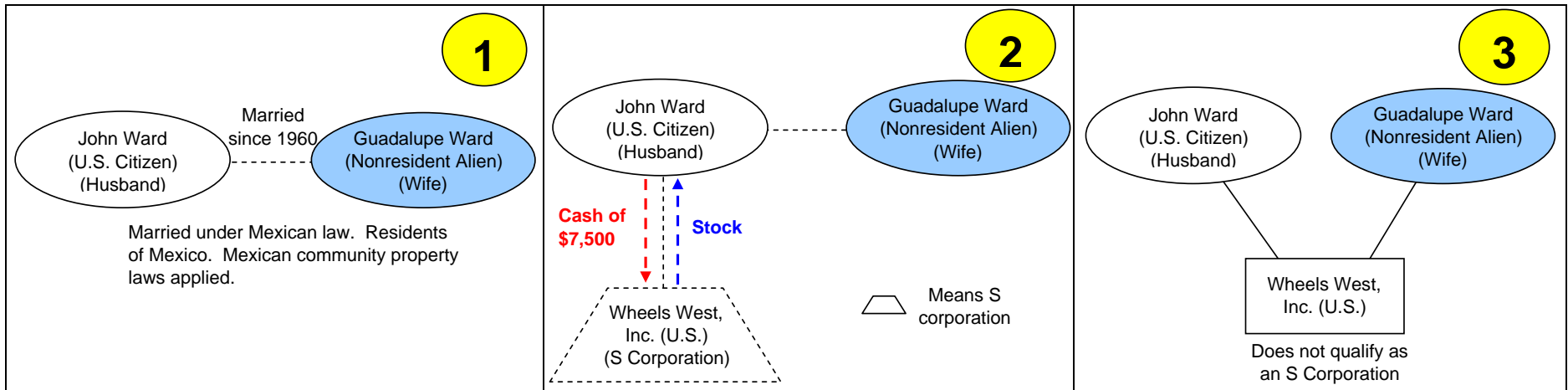


**NRA Spouse Owned Purported S Corp
 Stock Under Community Property Laws**

Initial Structure

S Corp Formation (1972)

Ending Point



John Ward and his wife were married in 1960, and their marriage was under the community property system of Mexico. John Ward was a U.S. citizen. John Ward's wife was a nonresident alien. The primary issue to be decided in the case was whether John Ward's wife was or was not a shareholder in Wheels West, Inc., a purported S Corporation. Under section 1361(b)(1)(C), a corporation that has a nonresident alien as a shareholder is not eligible to be an S corporation.

Wheels West, Inc., was organized by John Ward under the laws of New Mexico in 1972. Seventy shares of capital stock in the corporation were issued in the name of John S. Ward. No other stock was issued by the corporation. In payment for the shares of stock, John Ward drew a check in the amount of \$7,500 on his account with the Southwest National Bank of El Paso, Texas, the check being payable to Wheels West, Inc. John Ward obtained the \$7,500 by borrowing the money from the profit-sharing plan of his employer. On February 15, 1972, John Ward executed, a Form 2553, Election by Small Business Corporation.

Under the community property system of Mexico, all the property acquired by the husband or the wife during the existence of the marriage is the community property of, and is owned jointly by, the husband and wife, except that property acquired by the husband or the wife through donation, inheritance, or "act of fortune" is the personal property of the acquiring spouse. The shares of stock in Wheels West, Inc., which John Ward acquired in 1972 were not acquired through donation, inheritance, or an "act of fortune." As a result, the stock became the community property of, and was owned jointly by, John Ward and his wife. Hence, John Ward's wife, a nonresident alien, was a shareholder in Wheels West, Inc. For that reason, Wheels West, Inc., did not qualify as a "small business corporation," and its purported 1972 S corporation election was ineffective.