

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200734014**
Release Date: 8/24/2007

Third Party Communication: None
Date of Communication: Not Applicable

Index Number: 1362.00-00, 1362.01-00

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-149655-06
Date: May 14, 2007

Legend

X =

Y =

A =

B =

n =

n1 =

n2 =

State =

D1 =

D2 =

Dear :

This letter responds to a letter dated October 9, 2006, submitted on behalf of X, requesting relief for an inadvertent termination under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated on D1 pursuant to the laws of State, and filed an S corporation election, effective D1. On D2, n shares of X were transferred to an ineligible shareholder, Y. Despite this transfer, however, the net income attributable to the n shares transferred to Y was reported by two taxpayers, A and B, represented to be eligible S corporation shareholders. To rectify the situation, X has cancelled the stock certificate of the n shares and reissued n1 and n2 shares to A and B, respectively.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments that the Commissioner may require consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

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 an S 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) will be terminated whenever (at any time on or after the 1st day of the 1st 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 in relevant part that if: (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation, as the case may be) as may be required by the Secretary with respect to such period, then,

notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely upon the facts presented and the representations made, we conclude that X's S corporation election terminated on D2. We also conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2 and thereafter, provided that X's subchapter S election is not otherwise terminated under § 1362(d).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) 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 your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
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