

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B1
PLR-121724-07
Date:
August 30, 2007

Legend:

X =

Y =

Z =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear _____ :

This letter responds to the letter dated May 7, 2007, and related correspondence, written on behalf of X, requesting relief for inadvertent termination of a subchapter S election under section 1362(f) of the Internal Revenue Code ("Code").

Facts:

You have represented that the facts are as follows. X is a corporation that made an S corporation election effective Date 1. On Date 2, a portion of the stock of X was transferred from Y, an eligible shareholder, to Z, an ineligible shareholder. On or about Date 3, X was informed by its tax advisors that the transfer of X stock caused X's S election to terminate. To rectify the situation, the stock held by Z was transferred back to Y on Date 4.

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 section 1362(a) is in effect for the 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 section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual.

Section 1362(d)(2)(A) provides that an election under section 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 that if (1) an election under section 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or (B) was terminated under section 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 section 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.

Conclusion:

Based solely on the information submitted and representations made, we conclude that X's S corporation election terminated because X had an ineligible shareholder. However, we conclude that such termination was inadvertent within the meaning of § 1362(f). Consequently, we rule that X will be treated as continuing to be an S corporation from Date 2, and thereafter, provided that X's S corporation election was valid and was 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 the your authorized representative.

Sincerely,

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel
Passthroughs & Special Industries

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

cc: