

Internal Revenue Service

Department of the Treasury
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LEGEND

X =

Y =

State =

Year =

Date 1 =

Date 2 =

Date 3 =

A =

B =

Month =

Dear :

This responds to a letter dated October 1, 2007, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted and representations made, we understand the relevant facts to be as follows: X was incorporated in Year under the laws of State. Effective Date 1, X elected to be treated as an S corporation and elected to treat its wholly-owned subsidiary Y as a qualified subchapter S subsidiary (QSub). From Date 2 to Date 3, several putative transfers of X stock were made from an eligible shareholder, A, to an individual retirement account (IRA), an ineligible shareholder, for the benefit of B. It is unclear whether these transfers were valid under State law and an agreement among X's shareholders. A, B, the IRA, and X were all unaware that the transfer of X shares to an IRA would cause a termination of X's S corporation election. In Month, X's counsel discovered that the putative transfer of X shares to the IRA may have caused a termination of X's S election. The IRA then promptly transferred all of X shares that had been putatively transferred to it back to A, along with all distributions that were made on those X shares while they were held by the IRA.

X represents that the circumstances resulting in the possible termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders agree to make any adjustments required by the Secretary 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) defines a "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(b)(3)(B) provides that a QSub is any domestic corporation that is not an ineligible corporation (as defined in § 1361(b)(2)) if (i) 100 percent of the stock of such corporation is held by an S corporation, and (ii) the S corporation elects to treat such corporation as a QSub.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which a

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), § 1361(b)(3)(B)(ii), or § 1361(c)(1)(A)(ii) 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), § 1361(b)(3)(C), or § 1361(c)(1)(D)(iii), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or a QSub, as the case may be, or (B) to acquire the required shareholder consents, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

CONCLUSION

Based solely on the information submitted and the representations made, we conclude that X's S election may have terminated on Date 2 because there may have been a transfer of X shares to an ineligible shareholder. In addition, we conclude that if there was a termination, the termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation from Date 2, and thereafter, provided that X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d). Additionally, Y will be treated as a QSub of X from Date 2, and thereafter, provided that Y's QSub election was otherwise valid and not otherwise terminated under § 1361(b)(3)(C).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether X is otherwise eligible to be treated as an S corporation or whether Y is otherwise eligible to be treated as a QSub.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/s/

Dianna K. Miosi
Chief, Branch 1
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for § 6110 purposes

cc: