

Internal Revenue Service

Number: **200901002**
Release Date: 1/2/2009

Index Number: 1362.00-00, 1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No.

Telephone Number: _____

Refer Reply To:
CC:PSI:B02
PLR-110410-08
Date:
September 29, 2008

Legend

X =

State =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

Trust5 =

Trust6 =

A =

B =

C =

D =

E =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

Date9 =

Date10 =

Date11 =

Date12 =

Date13 =

Date14 =

a =

Dear _____ :

This responds to a letter dated February 27, 2008, submitted on behalf of X by X's authorized representative, requesting rulings under § 1362(f) of the Internal Revenue Code (the Code) with respect to the events described below.

The information submitted states that X was incorporated under the laws of State on Date1. X elected to be an S corporation effective Date2. On Date3, through a plan of reorganization and merger, X became the successor entity to a group of entities previously affiliated through common ownership and by inter-company agreements and transactions. In exchange for interests in the various merged companies and equipment, the transferors received shares of stock in X.

The information submitted further states that A and B were married on Date4. A and B established Trust1 on Date5. A died on Date6. Trust2 was established pursuant

to the terms of governing instrument of Trust1, and A's estate was transferred to Trust2 on or about Date7. Trust2, as an owner of an entity that participated in the merger with X on Date3, acquired a shares of X as a result of that merger. On Date8, Trust2 sold all of its shares of X to the children of A and B.

X represents that Trust2 at all times met the requirements to be a qualified subchapter S trust (QSST) under § 1361(d). X also represents that all of the income with respect to the stock of X that was held by Trust2 had been consistently reported by B on her individual return as if the QSST election for Trust2 had been in effect since Date3. However, B, as the current income beneficiary of Trust2, failed to make the election under § 1361(d)(2) to be treated as a QSST. Pursuant to its governing instrument, Trust2 terminated on Date9, the date of death of B.

X represents that X and X's shareholders have filed tax returns consistent with X being an S corporation. X further 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 each person who was or is a shareholder of X at any time since Date3 agree to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

In addition to the terminating event described above, X and its shareholders are concerned that X's status as an S corporation may have been endangered due to two other potential terminating events. First, X represents that on or about Date10, shares of X were transferred to four trusts, Trust3, Trust4, Trust5, and Trust6, that qualified and properly elected to be treated as electing small business trusts (ESBTs) under § 1361(e). However, the governing instruments for the trusts conferred powers to Special Trustees to make amendments to the governing instruments under certain circumstances. X and its shareholders are concerned that these powers potentially conferred to the Special Trustees the ability to appoint additional income beneficiaries for the trusts, and therefore may have caused X to cease to be a small business corporation under § 1361(b)(1)(A) and its S corporation election to terminate under § 1362(d)(2). Corrective action was taken with respect to the trusts on Date11.

Second, X represents that on or about Date12, all of the shareholders of X entered into a Stockholders Agreement. The Stockholders Agreement included a "call" provision intended to enable X to make certain tax elections that could otherwise be blocked by a minority shareholder who may not consent to such elections. The call provision provided that if a shareholder declined to consent to certain actions approved by a majority of the shareholders, X and its other shareholders had the right to purchase the non-consenting shareholder's shares at less than appraised value. X and its shareholders are concerned that this call provision potentially may have created a second class of stock that would have caused X to cease to be as a small business corporation under § 1361(b)(1)(D) and its S corporation election to terminate under § 1362(d)(2). X represents that all outstanding shares of stock in X otherwise conferred identical rights to distribution and liquidation proceeds. X further represents that the call provision contained in the Stockholders Agreement never was exercised, and no

possibility exists that this provision will be exercised in the future due to recent stock transactions.

In addition to the two potentially terminating events described above, X and its shareholders are concerned that X's election as an S corporation may have been ineffective due to two other events that may have prevented all of its shareholders from consenting to the S corporation election. First, X represents that on Date2 certain shares were held by C as a "Trustee". X further represents that C was a nominee and was not a fiduciary with respect to these shares, and that C was not the beneficial owner of these shares. Nevertheless, X and its shareholders are concerned that its S corporation election potentially could be deemed to have been ineffective because C, as a "Trustee", did not sign the Form 2553 to consent to X's S corporation election on Date2. On Date13, X took corrective action within a reasonable time by issuing a replacement stock certificate to the beneficial owner.

Second, D was a shareholder of X on Date2. D and E, husband and wife, resided in State, a community property state, at all times during their marriage. X represents that it believes that, under the laws of State, the shares of X were always the separate property of D. Nevertheless, X and its shareholders are concerned that its S corporation election potentially could be deemed to have been ineffective because E did not sign the Form 2553 to consent to X's S corporation election on Date2. Corrective action was taken by X, D and E within a reasonable time.

Section 1362(f) provides that if (1) an election under § 1362(a) by a 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 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 (B) to acquire the 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 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 the ineffectiveness or termination, the corporation will 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 S corporation election terminated on Date3 resulting from the failure of B, as the beneficiary of Trust2, to make the election under § 1361(d)(2). We further conclude that the termination was inadvertent within the meaning of § 1362(f). In addition, we conclude that, to the extent that X's S corporation election would have terminated as a result of any of the other events described above, had it not already terminated on Date3, or to the extent that any of the events described above may have caused X's S corporation election on Date2 to be ineffective, such termination or ineffectiveness was

inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as being an S corporation beginning on Date2, and continuing to be an S corporation from Date3 and thereafter, provided that X's S corporation election was valid and the election was not otherwise terminated under § 1362(d) for reasons not addressed in this letter.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was or is a small business corporation under § 1361(b), whether Trust2 qualified to be treated as a QSST within the meaning of § 1361(d)(3), or whether Trust3, Trust4, Trust5, and Trust6 qualify as ESBTs within the meaning of § 1361(e).

This ruling 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.

In accordance with the power of attorney on file with this office, this letter and copies are being sent to X's authorized representatives.

Sincerely,

Melissa C. Liquerman
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes

cc: