

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
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Telephone Number:

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Date:
October 20, 2008

Legend:

X =

Sub1 =

Sub2 =

Sub3 =

Sub4 =

Sub5 =

Sub6 =

LP =

IRA =

A =

B =

a =

b =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

Date9 =

State =

Dear :

This letter responds to a letter dated May 2, 2008, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

X incorporated under State law on Date1. X elected under § 1362(a) to be treated as an S corporation effective Date1. X has two shareholders, A and B. Sub1, Sub2, Sub3, Sub4, Sub5, and Sub6 are the wholly-owned subsidiaries of X. X elected to treat Sub1 and Sub3 as qualified subchapter S subsidiaries effective Date4; Sub2, Sub5, and Sub6, effective Date2; and Sub4 effective Date3.

On Date6, A transferred a shares of X to LP, a State limited partnership, and thus an ineligible S corporation shareholder under § 1361(b)(1)(B). X's S corporation election therefore terminated on Date6.

On Date7, an employee of X filed a statement with the Service purporting to revoke X's S corporation election, effective Date5. The filing of the purported revocation was not authorized by X or its shareholders.

On Date8, X issued b shares of X to IRA, an individual retirement account, and thus an ineligible S corporation shareholder under § 1361(b)(1)(B).

Upon discovery of the events described above and the termination of X's S corporation status, on Date9 X and its shareholders took immediate corrective action.

X represents that X and its shareholders have at all times intended X to be an S corporation since its election effective Date1. X further represents that X and its shareholders have treated themselves consistent with S corporation status. X also 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 requests inadvertent S corporation termination relief under § 1362(f), and that it be treated as an S corporation effective Date1.

Law

Section 1361(a) 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) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which 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 1 class of stock.

Section 1362(a)(1) provides, in general, that except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall 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(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 § 1362(d)(3), § 1361(b)(3)(C), or § 1361(c)(1)(D)(iii), (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 for which the election was made or the termination occurred is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or (B) to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) 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 or a qualified subchapter S subsidiary, as the case may be during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that, for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

Conclusion

Based on the facts submitted and representations made, we conclude that X's S corporation election was terminated on Date6 because LP was an ineligible S corporation shareholder under § 1361(b)(1)(B). We also conclude that the termination

was inadvertent within the meaning of § 1362(f). Consequently, we conclude that X will be treated as continuing to be an S corporation from Date6 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated.

Accordingly, all of the shareholders of X, in determining their respective income tax liabilities for the termination period of Date6 to Date9 and thereafter must include their pro rata share of separately and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368.

LP and IRA must not be treated as shareholders for any period LP and IRA held an interest in X. Accordingly, this ruling is conditioned on A and B treating themselves as the only shareholders of X during the termination period of Date6 to Date9. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

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 or implied concerning whether X was eligible to make the S corporation election or whether X otherwise qualifies as an S corporation.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

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

The ruling contained in this letter is 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 ruling request, it is subject to verification on examination.

Sincerely,

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter
A copy for § 6110 purposes