Internal Revenue Service

Department of the Treasury
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Date:
April 05, 2007

Company =

State1 =

State2 =

State3 =

Spouse Set A =

Spouse Set B =

Spouse Set C =

Agreement(s) =

a =

b =

c =

d =

e =

f =

g =

h =

i =

Dear :

This letter responds to a letter dated September 21, 2006, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

Company was incorporated in a under the laws of State1 and subsequently elected to be an S corporation under § 1362(a) by filing Form 2553, Election by a Small Business Corporation. Company reincorporated in State2 on b, and again elected to be an S corporation with an effective date of b. At the time of its reincorporation, Company's stock was owned by Spouse Set A, Spouse Set B, and Spouse Set C (collectively, "Shareholders" or "Spouse Sets").

In c, estate planning advisers presented Shareholders with a proposed wealth transfer plan involving the creation of three family limited partnerships. Under the plan, the partnerships would hold, among other assets, Shareholders' stock in Company.

Pursuant to the plan, the Spouse Sets each formed a corporation ("Corporation") in State3. Each of the Spouse Sets and their respective Corporation formed a family limited partnership ("Partnership"). For each Partnership, the respective Corporation owned a d percent general partnership interest, and each spouse of the respective

Spouse Sets owned an e percent general partnership interest and an f percent limited partnership interest. Each of the Spouse Sets then assigned their stock in Company to their respective Partnership on g. Once the Partnerships were formed and funded, each of the Spouse Sets transferred by gift their limited partnership interests to their respective children and, in the case of Spouse Set B, their grandchildren.

On h, prior to the stock assignments to the Partnerships, the Shareholders' estate planning advisers created a trust ("Trust") for each of the Spouse Sets. The Trusts were formed to hold the stock in Company as qualified subchapter S trusts ("QSSTs"). However, the Shareholders were not advised of the required QSST elections and no QSST elections were filed for the Trusts. Each of the Shareholders' stock in Company was re-titled in the name of each of the Spouse Sets' respective Trust for the benefit of their respective Partnership.

In i, Company and the Shareholders engaged a separate accounting firm to review the estate planning transactions and resulting corporate structure. Company and the Shareholders were advised of the termination of Company's S corporation election resulting from the transfers of Company stock by the Shareholders to their respective Partnerships on g. Subsequently, legal counsel representing the Spouse Sets filed petitions in a State2 district court to rescind the formation of the Partnerships, the transfers of Company stock to the Partnerships, and the transfers by gift of limited partnership interests in the Partnerships to the children and grandchildren of the Spouse Sets ("Transactions"). As a result, the court issued an order decreeing each of the Transactions void ab initio and of no effect. Immediately thereafter, Company cancelled Company stock certificates issued to the Trusts for the benefit of their respective Partnerships and issued new stock certificates to the Shareholders.

Company represents that the terminating events were not motivated by tax avoidance or retroactive tax planning. In addition, Company and its Shareholders agree to make any necessary adjustments consistent with the treatment of Company as an S corporation.

LAW

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, 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) terminates whenever the corporation ceases to be a small business corporation.

For S corporation elections made and terminations occurring before January 1, 2005, § 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made 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 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 the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that Company's S corporation election terminated due to the transfer of Company stock to the Partnerships on g. We additionally conclude that the termination was inadvertent within the meaning of § 1362(f). Consequently, we rule that Company will continue to be treated as an S corporation from g, and thereafter, provided Company's S election is not otherwise terminated under § 1362(d). As a condition for this ruling, the Partnerships and the Trusts must not be treated as shareholders for any time they held Company stock. Accordingly, for the time the Partnerships or Trusts held Company stock, the Shareholders must include their pro rata shares of the separately and nonseparately computed items attributable to those shares in their income as provided in § 1366, make adjustments to the stock basis of those shares as provided in § 1367, and take into account any distributions with respect to those shares as provided in § 1368, all in compliance with certain Agreement(s) reached with the Service.

Except for the specific ruling above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding Company's eligibility to be an S corporation.

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

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

/s/

CHRISTINE ELLISON
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosures: copy of this letter
copy for § 6110 purposes