Internal Revenue Service

Number: **200802004**
Release Date: 1/11/2008

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:B03
PLR-115268-07

Date: September 28, 2007

LEGEND

Company =

State =

Trust =

Grantors =

Entity =

a =

b =

c =

d =

Dear :

We received your letter dated March 16, 2007, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code. This letter responds to that request.

FACTS

Company incorporated on a under the laws of State and elected to be treated as an S corporation effective b. Company's sole shareholder from the date of its incorporation until c was Trust, a grantor trust. In c, Trust created Entity and contributed one percent of Company's stock to Entity in exchange for all of Entity's stock. Entity was an ineligible shareholder under § 1361(b)(1)(B). On d, Company learned that its S corporation election had terminated in c when Entity became a shareholder of Company. Subsequently, Trust liquidated Entity and distributed Company stock back to Trust, making Trust the sole shareholder of Company.

Company represents that there was no tax avoidance or retroactive tax planning involved in the transfer of its stock to Entity. In addition, Company, Trust, and Entity agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

LAW

Section 1361(a)(1) provides that for purposes of subchapter S, 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)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and which does not 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.

Except as provided in § 1362(g), § 1362(a)(1) provides that 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) is terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 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 so that the corporation for which the election was made or the termination occurred is a small business corporation; and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in 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 this period, then, notwithstanding the circumstances resulting in such ineffectiveness or the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that 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. In the case of a transfer of stock to an ineligible shareholder that causes an inadvertent termination under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of an S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent any loss of revenue due to a transfer of stock to an ineligible shareholder (e.g., a transfer to a nonresident alien.)

CONCLUSION

Based on the facts submitted and representations made, we conclude that the termination of Company's S corporation election due to the transfer of Company stock to Entity, an ineligible shareholder, was inadvertent within the meaning of § 1362(f). Consequently, upon the conditions prescribed below, we conclude that Company will continue to be treated as an S corporation from c, and thereafter, unless Company's S election otherwise terminates under § 1362(d).

This ruling is contingent on Company treating Trust as owning the shares of Company stock held by Entity from c and thereafter. Accordingly, Trust, the sole shareholder of Company, must include its pro rata share of Company's items of income (including tax-exempt income), loss, deduction, or credit the separate treatment of which could affect the liability for tax of any shareholder, and nonseparately computed income or loss as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions with respect to those shares as provided in § 1368.

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

Under a power of attorney on file with this office, we are sending the original of this letter to Company and a copy to Company's 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.

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,

/s/

Christine Ellison
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

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