Internal Revenue Service

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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:B1
PLR-135186-07

Date:
January 08, 2008

Legend:

X =

A =

B =

C =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to your letter dated July 31, 2007, requesting inadvertent termination relief under section 1362(f) of the Internal Revenue Code.

Facts:

You have represented that the facts are as follows. X is a corporation formed in State on Date 1. On Date 2, X filed an election to be taxed as an S corporation for federal tax purposes. On Date 3, X converted to State limited partnership in a transaction that was treated as a reorganization under § 368(a)(1)(F). This conversion may have created a second class of stock. Also on Date 3, X's S corporation election was terminated when A, an ineligible corporate shareholder, became the general partner of the limited partnership.

The following two remedial actions were taken on Date 5. First, X was converted from a State limited partnership back into a State corporation. Additionally, A divested itself of all of its interests in X by distributing them pro rata to its shareholders, B and C, who are both eligible shareholders.

X represents that it was unaware that the conversion to a limited partnership and the admission of A as a general partner could cause its S corporation election to terminate. X represents that it did not intend to terminate its S corporation election and that it has consistently filed its tax returns consistent with its treatment as an S corporation. X and its shareholders have agreed to make such adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

Law and Analysis:

Section 1361(a)(1) defines an S corporation as a "small business corporation" for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a "small business corporation" cannot have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2) or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(b)(1)(D) 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 more than one class of stock**.**

Section 1362(d)(2) 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. A termination of an S corporation election under § 1362(d)(2) 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 paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation is a small business corporation, 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 such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion:

Based solely on the facts represented, we conclude that X's S corporation election was terminated on Date 3, when A, an ineligible shareholder, acquired an interest in X. We also conclude that this termination was inadvertent within the meaning of § 1362(f). In addition, if X's conversion from a State corporation to a State limited partnership did create a second class of stock, the consequent termination of X's S corporation election was inadvertent within the meaning of § 1362(f).

Therefore, we conclude that X will continue to be treated as an S corporation for the period from Date 3 and thereafter, provided that X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d). During the period from Date 4 and thereafter, B and C will be treated as the owners of the X stock acquired by A. The shareholders of X must include their pro rata share of the separately stated 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. If X or its shareholders fail to treat X as described above, this letter ruling will be null and void.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code. In particular, no opinion is expressed or implied concerning whether X's S corporation election was valid under § 1362.

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

Pursuant to a 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 for § 6110 purposes

cc: