

Dear _____ :

This letter responds to your letter dated August 3, 2007, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

X was formed under State law on Date1 and elected to be an S corporation effective Date1. On Date2, A and B transferred a a interest in X to Y, a corporation. On Date3, X learned that Y is an ineligible S corporation shareholder under § 1361(b)(1)(B) and that its S corporation election terminated on Date2. Subsequently, on Date4, the ownership interest issued to Y was cancelled and reissued to C, an individual.

X 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 its members agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary under § 1362(f).

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 one class of stock.

Section 1362(a)(1) provides, 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 first day of the first taxable year for which the corporation is an S corporation) such 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), § 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 § 1362(f), 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.

Conclusion

Based on the facts submitted and representations made, we conclude that X's S corporation election terminated on Date2 when A and B transferred the a interest in X to Y, 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 continue to be treated as an S corporation from Date2 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated.

During the termination period of Date2 to Date4, C will be treated as owning the interest in X that was previously held by Y. Accordingly, all of the members of X, including C, in determining their respective income tax liabilities during the termination period 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.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied as to 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,

/s/

Mary Beth Collins
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

cc: