

Internal Revenue Service

Department of the Treasury
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Legend

X:

Y:

A:

B:

C:

State:

Date 1:

Date 2:

Date 3:

Dear _____ :

This responds to a letter dated May 20, 2008, and subsequent correspondence submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was formed on Date 1. Effective Date 1, X elected to be an S corporation. When X filed its Form 2553, Election by a Small Business Corporation, X's shareholders were individuals, and Y, an S corporation. The shareholders of Y were A, B and C, all individuals. Y, as an S corporation, was an ineligible shareholder of another S corporation. In Date 2, X was advised by its counsel that Y was an ineligible shareholder of an S corporation and that X's S corporation election was ineffective. X's S corporation election may also have terminated on Date 1, because X was formed as a State limited partnership and there may have been a second class of stock. On Date 3, Y was merged into X now owned by A, B and C.

X represents that X and its shareholders did not intend to engage in tax avoidance or retroactive tax planning. X represents that the circumstances resulting in the ineffectiveness of X's election to be an S corporation were inadvertent. X represents that since Date 1, X and its shareholders, including Y, have filed federal income tax returns consistent with X's S corporation election. Y in turn, allocated those items to its shareholders, A, B and C. X represents that the amount of tax paid during this period was the same as if A, B and C had directly held X stock. X and each person who was or is a shareholder of X at anytime since Date 1, agree to make such adjustments, consistent with the treatment of X as an S corporation that the Secretary may require.

Section 1361(a)(1) 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)(B) provides that an S corporation cannot 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(a) provides that, except as provided in § 1362(g), a small business corporation may elect to be an S corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation 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, (2) the Secretary determines that the circumstances

resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, 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 in such 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 ineffectiveness, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the information submitted and the representations made, we conclude that X's S corporation election was ineffective on Date 1, because X had an ineligible shareholder. We also conclude that the election was inadvertently invalid under § 1362(f). Furthermore, X's S corporation election may have been ineffective on Date 1, when X was formed as a State limited partnership. In addition, we conclude that that possible ineffectiveness was inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as being an S corporation from Date 1 to Date 3, and thereafter, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d). All of X's shareholders in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X to its shareholders as provided in § 1368. If X or X's shareholders fail to treat X as described above, this ruling will be null and void.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 X's authorized representatives.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
(Passthroughs and Special Industries)

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

cc: