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Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-129366-08
Date:
December 29, 2008

Legend

X =

Y =

Trust1 =

Trust2 =

Trust3 =

Plan1 =

Plan2 =

Plan3 =

Plan4 =

IRA1 =

IRA2 =

IRA3 =

IRA4 =

IRA5 =

IRA6 =

IRA7 =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

a =

b =

c =

n =

Dear :

This responds to a letter dated July 1, 2008, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under §1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State1 on Date1, and elected to be an S corporation effective Date2. At the time of the S election, X had a shareholders, all of whom were permissible shareholders described in § 1361(b) that had consented to the S election. On Date3, X agreed to enter into a transaction with an unrelated third party involving the creation of a partnership between X and the third party. In connection with this transaction, certain entities and individuals were given the opportunity to purchase stock of X from existing X stockholders. X stock was purchased by b purchasers on Date4. However, c of these investors were not permissible S corporation shareholders under § 1361(b) on Date4 (the "impermissible shareholders"). Specifically, these impermissible shareholders were Trust1, Trust2 and Trust3, which are trusts not described in § 1361(c)(2); Plan1, Plan2, Plan 3 and Plan4, which are tax-exempt qualified retirement plans; IRA1, IRA2, IRA3, IRA4, IRA5 and IRA6, which are individual retirement accounts; and Y, which is a C corporation. X represents that Trust1, Trust2 and Trust3 had met the requirements of § 1361(e)(1) as electing small business trusts except for the fact that the required elections under § 1361(e)(3) were not made. On Date5, the shares of X held by Plan1 were transferred to IRA7, an individual retirement account.

X represents that, when X offered the opportunity to investors to purchase its stock, X was unaware that the purchase of its stock by the impermissible shareholders would cause a termination of its S election. Furthermore, X relied on a certified public accounting firm to prepare its income tax returns and for tax advice, but the accounting firm never advised X that the ownership of stock by the impermissible shareholders would result in the termination of X's S election. On Date6, for business reasons, all of the stock of X held by the impermissible shareholders, as well as several other shareholders, was redeemed by X. Accordingly, X qualified as a small business

corporation on Date6, and has continuously qualified as a small business corporation thereafter.

The period of limitations on assessments under § 6501(a) has expired for the taxable years ending before Date7. However, the period of limitations on assessments under § 6501(a) has not expired for the taxable years beginning on Date7, or for any subsequent years.

X represents that X and X's shareholders have filed tax returns consistent with X being an S corporation. X further 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 each person who was or is a shareholder of X at any time since Date4 agree to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

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 a "small business corporation" means a domestic corporation that is not an ineligible corporation and that 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.

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) 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. A termination of an S corporation election under § 1362(d)(2) is effective on or 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 termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the 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 under § 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 for that 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.

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date4 when stock of X was transferred to the impermissible shareholders. In addition, X's S corporation election would have terminated on Date5 when the stock of X was transferred to IRA7, if it had not already terminated. We conclude that the termination was inadvertent within the meaning of § 1362(f). We further conclude that, to the extent that X's S corporation election would have terminated as a result of the transfer to IRA7 on Date5, had the election not terminated earlier, such termination would have been inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on Date4 and thereafter, unless X's S corporation election otherwise terminated under § 1362(d) for reasons not stated in this letter, and provided that the following conditions are met.

As an adjustment under § 1362(f)(4), a payment of $n and a copy of this letter must be sent to the following address: Internal Revenue Service, Cincinnati Service Center, 201 West Rivercenter Blvd., Covington, KY 41001, Stop 31, Terri Lackey, Manual Deposit. This payment must be sent no later than Date8.

As a condition for this ruling, for the tax periods beginning on or after Date7 in which X reported a net loss, IRA1, IRA2, IRA3, IRA4, IRA5 and IRA6 will be treated as the shareholder of the shares of X stock. For the tax periods beginning on or after Date7 in which X reported a net gain, the respective beneficiary of each of IRA1, IRA2, IRA3, IRA4, IRA5 and IRA6 will be treated as the shareholder of the shares of X stock held by each. For the tax periods beginning on or after Date5 in which X reported a net loss, IRA7 will be treated as the shareholder of the shares of X stock. For the tax periods beginning on or after Date5 in which X reported a net gain, the beneficiary of IRA7 will be treated as the shareholder of the shares of X stock held by IRA7. The shareholders of X must include in income 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. This ruling is contingent upon X and its shareholders filing any amended returns and making such adjustments that are necessary to properly reflect the reporting of X's items of S corporation income. Any such amended returns must be filed within 90 days of the date of this letter. A copy of this letter should be attached to each return. If X or its shareholders fail to treat X as described above, this letter ruling shall 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, including whether X was or is a small business corporation under § 1361(b).

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: