**Internal Revenue Service**

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Date:
June 15, 2007

X =

D1 =

D2 =

D3 =

D4 =

D5 =

LP =

State =

A =

B =

Trust 1 =

Trust 2

Dear

This letter responds to a letter dated October 10, 2006, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1 and elected to be an S corporation effective D1. On D2, shares of X were transferred to LP, a State family limited partnership. A and B, along with other individuals, have at all times been partners in LP. A, the president of X, was not aware that LP was an ineligible shareholder of an S corporation and that the transfer would terminate X's S election. On D3, A and B engaged an attorney to review matters concerning X and LP. The attorney discovered shares of X had been transferred to LP and that this transfer terminated X's S election. Thereafter, X, A and B treated the transfer of the shares of X to LP as rescinded under State law. On D4, LP distributed all of its shares of X stock to Trust 1, which is owned by and for the benefit of A, and Trust 2, which is owned by and for the benefit of B. X represents that Trust 1 and Trust 2 are grantor trusts, permitted S corporation shareholders under § 1361(c)(2)(A)(i).

A represents that the termination of X's S election was inadvertent and was not motivated by tax avoidance or retroactive tax planning. Further, since D2, X and X's shareholders have continually treated X as an S corporation. As such, all items of income, gain, loss, and deduction recognized by X since D2 have been allocated among the shareholders of X, including LP. In turn, the partners of LP each reported, on their individual income tax returns for all taxable years since D2, their respective share of the income, gain, loss and deductions of X. X and its shareholders have agreed to make such adjustments as the Service may require with respect to all periods since D2.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable 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(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 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 § 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 event resulting in the 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 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 ineffectiveness, the 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 election was terminated on D2 when shares of X were transferred to LP, an ineligible shareholder. We conclude, however, that this termination was inadvertent within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation effective D2 and thereafter.

As of D5, A and B will be treated as if they held their respective shares in X directly. Accordingly, in determining their respective income tax liabilities from D5 and thereafter, X's shareholders must include their pro rata share of the 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. If X or its shareholders fail to treat themselves as described above, this 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. Specifically, no opinion is expressed on whether X was or is otherwise eligible to be treated as an S corporation.

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.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely,

J. Thomas Hines
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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