

**Internal Revenue Service**

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Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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PLR-147913-04

Date:

November 18, 2004

Legend

X =

Trust =

IRA1 =

IRA2 =

State =

D1 =

D2 =

D3 =

Dear :

This responds to a letter dated August 25, 2004, submitted on behalf of X by its authorized representative, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

**STATEMENT OF FACTS**

According to the information submitted and representations therein, X incorporated under the laws of State and elected S corporation status effective D1. On D2, X issued

PLR-147913-04

shares of its stock to Trust, an ineligible shareholder, thereby terminating X's S corporation election. On D3, a shareholder of X transferred shares of X's stock to IRA1 and to IRA2, both ineligible shareholders. These transfers would have terminated X's S corporation election had it not already terminated on D2.

X represents that at all times it has filed consistently with its belief that it was an S corporation. As soon as X discovered the terminating events, it initiated corrective action in order to once again become a small business corporation. Finally, X and each person who was a shareholder in X agree to make such adjustments (consistent with the treatment of the corporation 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 Section 1362(a) is in effect. Section 1361(b)(1) defines "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, other than a trust described in Section 1361(c)(2), and other than an organization described in (c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

### Transfer to Trust

Section 1361(c)(2)(A)(v) provides that, for purposes of Section 1361(b)(1)(B), trusts that may be shareholders include an electing small business trust.

Section 1361(e)(1)(A) provides that an "electing small business trust " (ESBT) means any trust if (i) such trust does not have as a beneficiary any person other than an (I) individual, (II) an estate, or (III) an organization described in paragraph (2), (3), (4), or (5) of Section 170(c) or (IV) an organization described in Section 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary; (ii) no interest in such trust was acquired by purchase, and (iii) an election under this subsection applies to such trust.

### Transfer to IRA1 and IRA2

Section 1.1361-1(f) of the Income Tax Regulations provides that except as otherwise provided in Section 1.1361-1(e)(1) (related to nominees), Section 1.1361-1(h) (relating to certain trusts), and, for taxable years beginning after December 31, 1997, Section 1361(c)(6) (relating to certain exempt organizations), a corporation in which any shareholder is a corporation, partnership, or trust does not qualify as a small business corporation.

Rev. Rul. 92-73, 1992-2 C.B. 224, holds that a trust that qualifies as an individual retirement account under Section 408(a) of the Code is not a permitted shareholder of an S corporation under Section 1361.

### Relief for Inadvertent Termination

Under Section 1362(d)(2), an election to be an S corporation will be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides that a corporation will be treated as continuing to be an S corporation during the period specified by the Secretary if (1) an election under Section 1362(a) by the corporation was terminated under paragraph (2) or (3) of Section 1362(d), (2) the Secretary determines that the termination was inadvertent, (3) no later than a reasonable period of time after discovery of the terminating event, steps were taken so that the corporation is once more 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 Section 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to that period.

### CONCLUSIONS

Based solely upon the facts submitted and the representations set forth above, we conclude that (1) X's S corporation election was terminated on D2 when it issued shares to Trust which did not properly elect to be treated as an ESBT and (2) had X's S corporation election not terminated on D2, it would have terminated on D3 when shares of its stock were transferred to IRA1 and IRA2. We also conclude that each of these terminating events constituted "inadvertent termination" within the meaning of Section 1362(f).

Accordingly, we conclude that, pursuant to Section 1362(f), X will be treated as continuing to be an S corporation from D2 and thereafter, assuming X's S corporation election is valid and not otherwise terminated under Section 1362(d).

This ruling is contingent upon the trustee of Trust filing an election to treat Trust as an ESBT with the appropriate service center within sixty days of the date of this letter. In addition, this ruling is contingent upon the transfer of the stock held by IRA1 and IRA2 to eligible shareholders on or before the date which is sixty days after the date of this letter.

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's original election to be an S corporation was a valid election under Section 1362.

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

Sincerely,

/s/ David R. Haglund

David R. Haglund  
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Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)  
Copy of this letter  
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