

## Internal Revenue Service

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Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-171452-03

Date:

July 26, 2004

In Re:

### Legend

X =

Trust =

D1 =

D2 =

D3 =

D4 =

State =

Dear :

This responds to the letter dated December 9, 2003 requesting relief under section 1362(f) of the Internal Revenue Code ("Code") for inadvertent termination of X's S election.

### FACTS

X is a corporation organized under the laws of the State on D1. X elected to be treated as a Subchapter S corporation effective D2. On D3, a portion of X's stock was transferred to Trust, an ineligible subchapter S shareholder. Upon discovery that Trust

was not a permitted S corporation shareholder, X redeemed the stock that Trust held on D4.

It is represented that at all relevant times, X and its shareholders treated X as an S corporation and filed their tax returns accordingly. X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

#### LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation", with respect to any taxable year, as a small business corporation for which an S election under section 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that a trust, all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States, may be a Subchapter S corporation shareholder.

Section 1362(f), in relevant part, provides that, if: (1) an election under section 1362(a) by any corporation was terminated under 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 event resulting in the termination, 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 in 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 such period, then, notwithstanding the terminating event, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

The Committee reports accompanying the Subchapter S Revision Act of 1982 explain section 1362(f) as follows:

If the Internal Revenue Service determines that a corporation's subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and the shareholders agree to be treated as if the election had

been in effect for such period.

The committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequence of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that the taxpayers and the government will work out agreements that protect the revenues without undue hardship to taxpayers . . . . It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24; H.R. Rep. No. 826, 97th Cong., 2d Sess. 12 (1982), 1982-2 C.B. 730, 735.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's Subchapter S election terminated upon the transfer of a portion of its stock to Trust on D3. We also conclude that the terminations constituted "inadvertent terminations" within the meaning of section 1362(f).

Further, we conclude that, pursuant to section 1362(f), X will be treated as continuing to be an S corporation from D3 and thereafter, assuming X's S corporation election is valid and not otherwise terminated under section 1362(d).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of the facts described above under any other provision of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) 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 your authorized representative.

Sincerely,

/s/ Dianna K. Miosi

Dianna K. Miosi  
Chief, Branch 1  
(Office of the Associate Chief Counsel)  
(Passthroughs and Special Industries)

Enclosures (2)  
Copy of this letter  
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