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**Internal Revenue Service**

Department of the Treasury  
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Person To Contact: \_\_\_\_\_, ID No. \_\_\_\_\_

Telephone Number:

Refer Reply To:  
CC:PSI:B01  
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Date: June 7, 2006

Legend:

X =Y =
$$\underline{Z} =$$

Trust =

Date 1 =

Date 2 =

Date 3 =

State =

Dear \_\_\_\_\_ :

This letter is in response to your letter, dated January 13, 2006, on behalf of X, requesting relief under section 1362(f) of the Internal Revenue Code.

## Facts

Based on the materials submitted and representations within, we understand the relevant facts to be as follows. X was incorporated on Date 1 under the laws of State. Y, an individual, was the sole shareholder of X. X elected to be an S corporation effective Date 1. On Date 2, X issued shares to Trust for the benefit of Z.

X represents that it did not realize at the time of the transfer that Trust was an ineligible shareholder. X represents that the transfer of X stock to Trust was not motivated by tax avoidance or retroactive tax planning. On Date 3, Trust transferred the shares to Z, an eligible shareholder. For all taxable years, X's shareholder's income was reported consistent with X qualifying as an S corporation. Furthermore, X and Z both treated Z as the owner of X stock. Both X and Z agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require.

### Law and Analysis

Section 1361(a)(1) of the Code defines an "S corporation" as a small business corporation for which an 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 and other than a trust described in section 1361(c)(2) or an organization described in section 1361(c)(6)) who is not an individual.

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

Section 1362(d)(2) provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the first day of the 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 section 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under section 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of section 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, 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 section 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 or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

### Conclusions

Based solely on the information submitted and representations made, we conclude that X's S corporation election was terminated on Date 2, when Trust, an ineligible shareholder, acquired X stock. We also conclude that this termination was inadvertent within the meaning of section 1362(f) of the Code. We further hold that under the provisions of section 1362(f), X will be treated as continuing to be an S corporation from Date 2 to Date 3, and thereafter, provided that X's S election was valid and was not otherwise terminated.

This ruling is contingent upon X treating Z, during the period from Date 2 to Date 3, as owning the X shares held by the Trust. Accordingly, the shareholders of X, in determining their respective income tax liabilities, must include their pro rata share of the separately stated and non-separately computed items of X under section 1366, make any adjustments to basis under section 1367, and take into account any distributions made by X as provided in section 1368.

Except as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. Specifically, no opinion is expressed on whether X was 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 the power of attorney on file with this office, copies of this letter will be sent to X's authorized representative.

Sincerely,

David R. Haglund  
Senior Technician Reviewer, Branch 1  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter

Copy of this letter for section 6110 purposes