Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

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CC:DOM:P&SI:1-PLR-101091-00
Date:
May 12, 2000

Legend:

X =

A =

D1 =

D2 =

D3 =

This responds to your letter dated December 29, 1999, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code.

FACTS

X was incorporated on D1. X elected subchapter S status, effective D1.

On D1, A purchased shares of X stock with a promissory note issued to X. On D2, A's individual retirement account ("IRA") paid the principal balance due on A's promissory note, and a stock certificate was issued in the name of the IRA.

Prior to D3, neither X, its officers, nor its shareholders were aware the IRA was an ineligible shareholder and that issuing stock to an IRA terminated X's S election. X represents that issuing stock to the IRA was not motivated by tax avoidance or retroactive tax planning. In addition, X and its shareholders 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 the period specified by section 1362(f) of the Code.

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 1362(d)(2)(A) 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 the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of the cessation. Section 1362(d)(2)(B).

Rev. Rul. 92-73, 1992-2 C.B. 224, holds that a trust qualified as an individual retirement account under section 408(a) is not a permitted S corporation shareholder under section 1361. *Rev. Rul. 92-73* further states that if a shareholder inadvertently causes a termination of an S corporation by transferring stock to a trust that qualifies as an individual retirement account under section 408(a), the shareholder may request relief under section 1362(f).

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.

CONCLUSIONS

Based solely on the fact submitted and the representations made, we conclude that X's subchapter S election terminated on D2 when X's stock was issued to the IRA. We also conclude that the termination constituted an "inadvertent termination" within the meaning of section 1362(f). Pursuant to section 1362(f), X will be treated as continuing to be an S corporation from D2, provided that during the period from D2 to D3, A will be treated as the owner of the IRA's shares of stock.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether the original election made by X to be treated as an S corporation was a valid election under section 1362.

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 the taxpayer.

Sincerely,
Signed/Dianna K. Miosi
Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

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