

(d) *Examples.* The provisions of this section are illustrated by the following examples:

*Example 1. S termination year not created.* (i) On January 1, 1993, the first day of its taxable year, a subchapter C corporation had three eligible shareholders. During 1993, the corporation properly elected to be treated as an S corporation effective January 1, 1994, the first day of the succeeding taxable year. Subsequently, a transfer of some of the stock in the corporation was made to an ineligible shareholder. The ineligible shareholder still holds the stock on January 1, 1994.

(ii) The corporation fails to meet the definition of a small business corporation on January 1, 1994, and its election is treated as having terminated on that date. See § 1.1362-2(b)(2) for the termination rules. Because the corporation ceases to be a small business corporation on the first day of a taxable year, an S termination year is not created. In addition, if the corporation in the future meets the definition of a small business corporation and desires to elect to be treated as an S corporation, the corporation is automatically granted consent to reelect before the expiration of the 5-year waiting period. See § 1.1362-5 for special rules concerning automatic consent to reelect.

*Example 2. More than 50 percent change in ownership during S short year.* A, an individual, owns all 100 outstanding shares of stock of S, a calendar year S corporation. On January 31, 1993, A sells 60 shares of S stock to B, an individual. On June 1, 1993, A sells 5 shares of S stock to PRS, a partnership. S ceases to be a small business corporation on June 1, 1993, and pursuant to section 1362(d)(2), its election terminates on that date. Because there was a more than 50 percent change in ownership of the issued and outstanding shares of S stock, S must assign the items of income, loss, deduction, or credit for the S termination year to the two short taxable years on the basis of S's normal method of accounting under the rules of paragraph (b)(3) of this section.

*Example 3. More than 50 percent change in ownership during C short year.* A, an individual, owns all 100 outstanding shares of stock of S, a calendar year S corporation. On June 1, 1993, A sells 5 shares of S stock to PRS, a partnership. S ceases to be a small business corporation on that date and pursuant to section 1362(d)(3), its election terminates on that date. On July 1, 1993, A sells 60 shares of S stock to B, an individual. Since there was a more than 50 percent change in ownership of the issued and outstanding shares of S stock during the S termination year, S must assign the items of income, loss, deduction, or credit for the S termination year to the two short taxable years on the basis of S's normal method of ac-

counting under the rules of paragraph (b)(3) of this section.

*Example 4. Stock acquired other than by sale or exchange.* C and D are shareholders in S, a calendar year S corporation. Each owns 50 percent of the issued and outstanding shares of the corporation on December 31, 1993. On March 1, 1994, C makes a gift of his entire shareholder interest to T, a trust not permitted as a shareholder under section 1361(c)(2). S ceases to be a small business corporation on March 1, 1994, and pursuant to section 1362(d)(2), its S corporation election terminates effective on that date. As a result of the gift, T owns 50 percent of S's issued and outstanding stock. However, because T acquired the stock by gift from C rather than by sale or exchange, there has not been a more than 50 percent change in ownership by sale or exchange of S that would cause the rules of paragraph (b)(3) of this section to apply.

[T.D. 8449, 57 FR 55452, Nov. 25, 1992, as amended by T.D. 8842, 64 FR 61205, Nov. 10, 1999]

#### § 1.1362-4 Inadvertent terminations.

(a) *In general.* A corporation is treated as continuing to be an S corporation during the period specified by the Commissioner if—

(1) The corporation made a valid election under section 1362(a) and the election terminated;

(2) The Commissioner determines that the termination was inadvertent;

(3) Steps were taken by the corporation to return to small business corporation status within a reasonable period after discovery of the terminating event; and

(4) The corporation and shareholders agree to adjustments that the Commissioner may require for the period.

(b) *Inadvertent termination.* For purposes of paragraph (a) of this section, the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event,

tends to establish that the termination was inadvertent.

(c) *Corporation's request for determination of an inadvertent termination.* A corporation that believes its election was terminated inadvertently may request a determination of inadvertent termination from the Commissioner. The request is made in the form of a ruling request and should set forth all relevant facts pertaining to the event including, but not limited to, the facts described in paragraph (b) of this section, the date of the corporation's election under section 1362(a), a detailed explanation of the event causing termination, when and how the event was discovered, and the steps taken to return the corporation to small business corporation status.

(d) *Adjustments.* The Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner. In the case of a transfer of stock to an ineligible shareholder that causes an inadvertent termination under section 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of an S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent any loss of revenue due to a transfer of stock to an ineligible shareholder (e.g., a transfer to a non-resident alien).

(e) *Corporation and shareholder consents.* The corporation and all persons who were shareholders of the corporation at any time during the period specified by the Commissioner must consent to any adjustments that the Commissioner may require. Each consent should be in the form of a statement agreeing to make the adjustments. The statement must be signed by the shareholder (in the case of shareholder consent) or a person authorized to sign the return required by section 6037 (in the case of corporate consent). See § 1.1362-6(b)(2) for persons required to sign consents. A shareholder's consent statement should include the name, address, and taxpayer

identification numbers of the corporation and shareholder, the number of shares of stock owned by the shareholder, and the dates on which the shareholder owned any stock. The corporate consent statement should include the name, address, and taxpayer identification numbers of the corporation and each shareholder.

(f) *Status of corporation.* The status of the corporation after the terminating event and before the determination of inadvertence is determined by the Commissioner. Inadvertent termination relief may be granted retroactive for all years for which the terminating event was effective, in which case the corporation is treated as if its election had not terminated. Alternatively, relief may be granted only for the period in which the corporation again became eligible for subchapter S treatment, in which case the corporation is treated as a C corporation during the period for which the corporation was not eligible to be an S corporation.

[T.D. 8449, 57 FR 55453, Nov. 25, 1992]

#### § 1.1362-5 Election after termination.

(a) *In general.* Absent the Commissioner's consent, an S corporation whose election has terminated (or a successor corporation) may not make a new election under section 1362(a) for five taxable years as described in section 1362(g). However, the Commissioner may permit the corporation to make a new election before the 5-year period expires. The corporation has the burden of establishing that under the relevant facts and circumstances, the Commissioner should consent to a new election. The fact that more than 50 percent of the stock in the corporation is owned by persons who did not own any stock in the corporation on the date of the termination tends to establish that consent should be granted. In the absence of this fact, consent ordinarily is denied unless the corporation shows that the event causing termination was not reasonably within the control of the corporation or shareholders having a substantial interest in the corporation and was not part of a plan on the part of the corporation or of such shareholders to terminate the election.