Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index Number: 1362.04-00

Number: **200035028**
Release Date: 9/1/2000

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:3 PLR-103271-00
Date:
June 5, 2000

Company:

State:

Trustees:

Trust A:

Trust B:

Trust C:

Trust D:

Trust E:

Trust X:

Trust Y:

Shareholders:

M:

a:

b:

c:

d:

Dear

This letter responds to a letter from your authorized representative dated February 3, 2000, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code that the termination of Company's S corporation election was inadvertent. Company represents the following facts.

Company was incorporated under the laws of State and elected under § 1362(a) to be an S corporation effective a. Company's S election terminated on b when Trustees failed to timely elect under § 1361(e)(3) to treat Trusts A, B, C, D, and E (the Subtrusts) as electing small business trusts (ESBTs). Company's shareholders for period b to d are listed in the legend of this letter.

Prior to b, Trusts X and Y, both of which were ESBTs, held Company stock. As a result of M's death on b, and pursuant to the terms of the trust agreements, Trusts X and Y distributed Company stock to the Subtrusts.

In c, Company's accountants discovered that the Subtrusts were nonqualifying S corporation shareholders, due to the absence of ESBT elections. On d, Trustees filed

ESBT elections for the Subtrusts with the Internal Revenue Service.

Company represents that its officers and directors, the Trustees, and the other relevant parties were unaware that each Subtrust had to make an ESBT election to avoid termination of Company's S election. Instead, the parties believed that the ESBT elections previously made by Trusts X and Y were sufficient for the Subtrusts. The parties intended for each Subtrust to be an ESBT and did not intend for Company's S election to terminate.

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(v) provides that an ESBT may be a shareholder of an S corporation for purposes of § 1361(b)(1)(B).

Section 1361(e)(1)(A) provides that, for purposes of § 1361, and except as provided in § 1361(e)(1)(B), the term "electing small business trust" means any trust if (i) the trust does not have as a beneficiary any person other than an individual, an estate, or an organization described in § 170(c)(2), (3), (4), or (5); (ii) no interest in the trust was acquired by purchase; and (iii) an election under § 1361(e) applies to the trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. The election shall apply to the tax year of the trust for which made and all subsequent tax years of the trust unless revoked with the consent of the Secretary.

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in termination, steps were taken so that the corporation is 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 § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as might be required by the Secretary regarding this period, then, notwithstanding the circumstances resulting in termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that 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.

According to the legislative history of § 1362(f)--

> 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 consequences of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that 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.

Company represents that none of the parties knew that the transfer of Company stock to the Trusts would terminate Company’s S election.

Based solely on the facts as represented by Company in this ruling request, we conclude that the termination of Company's S corporation election due to the failure of the Trustees to elect under § 1361(e) to treat the Subtrusts as ESBTs was inadvertent

within the meaning of § 1362(f).

Consequently, we rule that Company will continue to be treated as an S corporation for the period from b to d, and thereafter, unless Company's S election otherwise terminates under § 1362(d). As a condition for this ruling, each potential current beneficiary of a Subtrust must be treated as a shareholder of Company during the period from b to d.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding Company's eligibility to be an S corporation, the eligibility of the Subtrusts to be ESBTs, or the validity of the S corporation and ESBT elections.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,
ROBERT HONIGMAN
Acting Assistant to the Chief, Branch 3
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes