

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:3 PLR-103099-01  
Date:  
September 13, 2001

Company =

Estate =

Trust =

A =

B =

Shareholders =

Date 1 =

Date 2 =

Year 1 =

Dear

This letter responds to your letter dated December 18, 2000, and subsequent correspondence submitted on behalf of Company, requesting inadvertent termination

relief under section 1362(f) of the Internal Revenue Code.

### **FACTS**

Company made a valid election under § 1362(a) effective beginning on Date 1. When shareholder B died, Estate held B's shares until administration of Estate was completed. On Date 2, B's shares were transferred to Trust. A is the income beneficiary of Trust.

A represents that Trust met the requirements to become a Qualified Subchapter S Trust (QSST) under § 1361(d)(3) for all the years in which Trust was a shareholder of Company and that Trust will continue to meet the requirements in future years. In preparing Company's form 1120S for Year 1, Company's accountant discovered that A had not filed an election under § 1362(d)(2) to qualify Trust as a QSST.

Further, A represents that Company has filed returns as an S Corporation and has treated Trust as if the QSST election had been filed timely. A has reported Trust's share of income and other items on A's individual tax returns. Shareholders of Company have submitted affidavits stating that they have reported their share of income and other items on their individual income tax returns consistent with an S election. Shareholders of Company agree to make any adjustments required by the Commissioner.

Company requests a ruling that the failure to file the QSST election was inadvertent and that the Date 2 termination of Company's S corporation status was inadvertent under § 1362(f).

### **LAW AND ANALYSIS**

Section 1361(b)(1) defines the term "small business corporation" to mean a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1362(a) (2) provides that an election under § 1362(a) shall be valid only if all persons who are shareholders in the corporation on the day the election is made consent to the election.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be

terminated whenever (at any time on or after the 1<sup>st</sup> day of the 1<sup>st</sup> taxable year for which the corporation is an S corporation) such 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), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation is 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 agrees to make adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the termination period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that, for purposes of § 1.1362-4(a), 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.

### **CONCLUSIONS**

Based on the information submitted and representations made, we conclude that Company's S corporation election was terminated on Date 2 when Trust, an ineligible shareholder, received stock in Company. We further conclude that the termination and the failure to timely file the QSST election were inadvertent within the meaning of § 1362(f).

Under § 1362(f), Company will be treated as if it were an S corporation from Date 2 and thereafter, provided a QSST election with an effective date of Date 2 is filed with the appropriate service center within 60 days from the date of this letter, and Company's S corporation election was otherwise valid and not otherwise terminated under § 1362(d). Accordingly, Shareholders of Company, in determining their respective income tax liabilities, must include their pro rata share of the separately and nonseparately computed items of Company as provided in § 1367, and take into account any distributions made by Company as provided by § 1368. If Company, or any of the shareholders fail to treat Company as described above, this ruling shall be void. A copy of this letter should be attached to the QSST election.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether Company was and is a S corporation for federal tax purposes. No opinion is expressed concerning whether Trust meets the requirements of § 1361(d)(3).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

Under a Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,  
Christine Ellison  
Chief, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

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