

Internal Revenue Service

Department of the Treasury

Number: **200246009**
Release Date: 11/15/2002
Index Number: 1362.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:1-PLR-129522-02
Date:
Aug 6 2002

Legend:

X =

A =

Trust =

State =

D1 =

D2 =

a =

b% =

Dear :

This responds to your letter dated May 8, 2002, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code.

FACTS

X incorporated under the laws of State on D1. X elected to be treated as an S corporation effective D1. On D2, A transferred to Trust a shares of X stock, representing b% of the total X stock outstanding.

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Under the terms of Trust, the trustee is directed to take whatever procedural and administrative steps required to ensure that X's S election is maintained. At the time of the creation of Trust, both A and Trust intended that Trust would elect to be treated as a qualified subchapter S trust (QSST). However Trust did not timely file an election to be treated as a QSST.

From the effective date of X's S election, X has treated itself as an S corporation, filing Form 1120S for each taxable year. Aside from the election filing requirement, Trust satisfies all requirements to be a QSST. Upon learning of its termination, X immediately sought inadvertent termination relief.

X, A, Trust, and the beneficiary of Trust represent that at no time did they desire to terminate X's S corporation status. X, A, Trust, and the beneficiary of Trust have agreed to make any adjustments that the Commissioner of the Internal Revenue Service may require.

LAW AND ANALYSIS

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, 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 for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate and other than a trust described in section 1361(c)(2)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that a trust, all of which is treated as owned by an individual who is a citizen or resident of the United States, is a permitted shareholder of a small business corporation.

Section 1361(d)(1) provides that in the case of a qualified subchapter S trust (QSST) with respect to which a beneficiary makes an election under section 1361(d)(2), such trust shall be treated as a trust described in section 1361(c)(2)(A)(i), and for purposes of section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust consisting of stock in an S corporation with respect to which the election under section 1361(d)(2) is made.

In order to qualify as a QSST, section 1361(d)(3)(A) requires that (1) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust, (2) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (3) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (4) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary.

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Section 1362(d)(2)(A) provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under section 1362(d)(2)(A) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under section 1362(a) by any corporation was terminated under paragraph (2) or (3) of 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 of the corporation at any time during the period specified pursuant to this subsection, 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 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 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; H.R. Rep. No. 826, 97th Cong., 2d Sess. 12 (1982), 1982-2 C.B. 730, 735.

CONCLUSION

Based on the information submitted and the representations made, we conclude that X's S corporation election terminated on D2, as a result of the transfer of X stock to Trust, an ineligible shareholder. However, we conclude that the facts causing such ineligibility were inadvertent and that the termination of X's S corporation election as a result of the failure by Trust to elect to be treated as a QSST was 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 and thereafter, provided that the beneficiary of Trust files a QSST election within 60 days of the date of this letter, and that X's S election otherwise is not terminated under section 1362(d).

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed or implied as to whether X otherwise qualifies as an Subchapter S Corporation under section 1361 or whether Trust qualifies as a QSST under section 1361(d).

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

/s/Dianna K. Miosi

Dianna K. Miosi
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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