

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:B1-PLR-143849-02  
Date:  
Sept 4 2002

Legend

X =

D1 =  
D2 =

Trust 1 =

Trust 2 =

Dear :

This responds to your letter dated, July 29, 2002, on behalf of X, requesting inadvertent termination relief under §1362(f) of the Internal Revenue Code.

Facts

X elected to be an S corporation, effective D1. X has always reported as an S corporation. On D2, X stock was transferred to Trust 1 and Trust 2, both of which were ineligible shareholders, thereby terminating X's S corporation election. X represents that at the time of the transfer, Trust 1 was eligible to make a qualified subchapter S trust (a "QSST") election, under §1361(d)(2). However, due to an oversight, Trust 1's

beneficiary did not make a timely QSST election under § 1361(d)(2). When X's counsel discovered the terminating events, Trust 2 sold its X shares so as to no longer be a shareholder, and X submitted this private letter ruling request.

X represents that the transfer of stock to Trust 1 and Trust 2, and subsequent failure to file the QSST election for Trust 1, were not motivated by tax avoidance or retroactive tax planning. Further, X represents that from D2 until the present that X, the sole beneficiary of Trust 1, and all other shareholders of X have filed or will file returns consistent with X's status as an S corporation. X and its shareholders have agreed to make any adjustments that the Commissioner may require consistent with the treatment of X as an S corporation.

### Law and Analysis

Section 1361(a)(1) defines an S corporation as a small business corporation for which an election under § 1362(a) is in effect. Section 1361(b)(1) defines "small business corporation" as 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, other than a trust described in § 1361(c)(2), and other than an organization described in (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 1361(c)(2)(A)(i) provides that a trust, all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States, may be a subchapter S corporation shareholder.

Section 1361(d)(1) states that a QSST, with respect to which a beneficiary makes an election under § 1361(d)(2), will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)), of that portion of the QSST's S corporation stock to which the election under § 1361(d)(2) applies.

Under § 1361(d)(2)(A), the beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Under § 1362(d)(2), an election to be an S corporation will be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides that a corporation will be treated as continuing to be an S corporation during the period specified by the Secretary if (1) an election under § 1362(a) by the corporation was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the termination was inadvertent, (3) no later than a reasonable period of time after discovery of the terminating event, 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 § 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 that period.

S Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24, in discussing § 1362(f) of the Code, provides, in part, that:

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 even 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.

### Conclusion

Based solely on the facts submitted and the representations set forth above, we conclude that (1) X's corporation election was terminated on D2; and (2) the termination was inadvertent within the meaning of § 1362(f). Pursuant to § 1362(f), X will be treated as continuing to be an S corporation from D2 and thereafter, provided that the beneficiary of Trust 1 files a QSST election, with an effective date of D2, with the appropriate service center within 60 days of the date of this ruling. A copy of this letter must be attached to the QSST election.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed on whether X's original election to be an S corporation was a valid election under § 1362 or whether Trust 1 is a QSST within the meaning of § 1361(c)(2)(A)(i).

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your representative.

Sincerely,

**/s/ David R. Haglund**

David R. Haglund  
Senior Technician Reviewer, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

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