

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

July 18, 2003

X =

A =

B =

Trust =

d1 =

Year 1 =

Year 2 =

Year 3 =

Dear :

This responds to a letter dated December 2, 2002, and subsequent correspondence, requesting that the Service grant relief under § 1362(f) of the Internal Revenue Code for inadvertent termination of an S corporation election and an extension of time pursuant to § 301.9100-3 of the Procedure and Administration Regulations to make an election under § 1361(d)(2).

The information submitted states that X elected to be an S corporation effective beginning with its Year 1 taxable year. A, a shareholder of X, died on d1 of Year 2. Pursuant to X's will, X's shares were transferred to Trust. The trustee of Trust represents that Trust is qualified to be treated as a qualified subchapter S trust (QSST) described in § 1361(d)(1), except that B, the beneficiary of Trust, failed to make the election under § 1361(d)(2). Therefore, X's S corporation election terminated on d1 of Year 3.

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Since d1 of Year 2, X and its shareholders have filed income tax returns consistent with the treatment of X as an S corporation and Trust as a QSST described in § 1361(d)(1). X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require.

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

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not 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)(i) provides that for purposes of § 1361(b)(1)(B), 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 shareholder. Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(c)(2)(A)(iii) provides that a trust, with respect to stock transferred to it pursuant to the terms of a will, but only for the two-year period beginning on the day on which such stock is transferred to it, may be a shareholder in an S corporation.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1362(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and, for purposes of § 678(a), the beneficiary of such QSST will be treated as the owner of that portion of the QSST which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made. Under § 1361(d)(2)(A), a 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.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or

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required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or 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 under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Under § 301.9100-1(c), the Commissioner may grant a reasonable extension of time to make a regulatory election, or a statutory election (but no more than six months except in the case of a taxpayer who is abroad), under all subtitles of the Code, except E, G, H, and I. Requests for relief under § 301.9100-3 will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government. Section 301.9100-3(a). Section 301.9100-1(b) defines a regulatory election to include an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-1(a)

Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

Based solely on the facts and representations submitted, we conclude that X's S election terminated on d1 of Year 3 because of the ownership of X stock by the Trust, which ceased to be an eligible S corporation shareholder at the end of the two-year period described in § 1361(c)(2)(A)(iii). We also conclude that the termination of X's S election was inadvertent within the meaning of § 1362(f). We further conclude that under the provisions of § 1362(f), X will be treated as being an S corporation from d1 of Year 3 and afterwards, provided X's S corporation election was otherwise valid and was not otherwise terminated.

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We also conclude that the requirements of § 301.9100-3 have been satisfied. As a result, B is granted an extension of time for 60 days from the date of this letter to file a QSST election for Trust effective d1 of Year 2. A copy of this letter should be attached to the QSST election. A copy is provided for that purpose.

This ruling is contingent on X and all its shareholders treating X as having been an S corporation for the period beginning on d1 of Year 3, and thereafter. The shareholders of X must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this ruling will be null and void.

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, including whether X was or is a small business corporation under § 1361(b) and whether Trust is a QSST.

This ruling is directed only to the taxpayer requesting 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 X.

Sincerely,

Heather C. Maloy  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes