Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
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Refer Reply To:
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Date:
February 17, 2004

Legend:

X	=
Trust1	=
Trust2	=
A	=
B	=
State	=
D1	=
D2	=
D3	=
D4	=
D5	=

Dear .

This responds to your letter dated August 18, 2003, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

Facts

According to the information submitted and representations therein, X was incorporated under the law of State on D1. X made a valid election to be treated as a subchapter S corporation effective D2. On D3, A created Trust1. Trust1 was last amended on D4. Since the death of A, a separate and independent share of the trust estate (Trust2) has been held, according to the terms of Trust1, for the benefit of B, who is the sole current beneficiary of the separate and independent share.

On D5, Trust2 acquired shares of X stock. However, B inadvertently failed to file an election under § 1361(d)(2) to treat Trust2 as a qualified subchapter S trust (QSST). At all times since the acquisition of shares of X stock on D5, Trust2 has been treated as a grantor trust.

X and B mistakenly believed that Trust2 qualified as a grantor trust. Within a reasonable time after the discovery of the mistake, X submitted this ruling request seeking relief under § 1362(f).

It is represented that at all relevant times, X and its shareholders treated X as an S corporation and filed their tax returns accordingly. X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

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 a "small business corporation" as a domestic corporation which is not an ineligible corporation which 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 § 1362(c)(2)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), trusts that may be shareholders of an S corporation include a trust all of which is treated as owned by an individual who is a citizen or resident of the United States.

Section 1361(d)(1) provides in part that in the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under § 1361(d)(2) – such trust shall be treated as a trust described in § 1361(c)(2)(A)(i).

Section 1361(d)(3) provides that the term "qualified subchapter S trust" (QSST) means a trust – (A) the terms of which require that – (i) during the life of current income

beneficiary, there shall be only 1 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 income beneficiary in the trust shall terminate on the earlier of such 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 such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated 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 – (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consent, or (B) 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 termination, steps were taken – (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, 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 circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

The committee reports accompanying the Subchapter S Revision Act of 1982 explain § 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 solely on the facts submitted and the representations made, we conclude that X's election to be treated as an S corporation terminated on D5. We also conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f). Under the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D5, and thereafter, provided that the beneficiary of Trust2 files a QSST election for Trust2 with the appropriate service center, effective D5, within 60 days of the date of this letter and provided that X's S corporation election is not otherwise terminated under § 1362(d). A copy of this letter should be attached to the election.

Except as specifically provide herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether X is an S corporation for federal tax purposes and whether Trust2 is a QSST under § 1361(d).

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

Sincerely,

/s/ David R. Haglund

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

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

Cc: