Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index Number: 1362.04-00

Number: **199913025**
Release Date: 4/2/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:Br.1-PLR-121345-98
Date:
January 04, 1999

LEGEND

X =

Date1 =

Date2 =

Date3 =

A =

B =

Trust1 =

Trust2 =

This responds to your letter submitted on behalf of X and requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

You have represented that the facts are as follows. X was incorporated on Date1. With the consent of its shareholders, X elected to be treated as an S corporation

effective on Date2. X has filed a Form 1120S for the taxable year beginning on Date2, and for every year thereafter.

On Date3, two of X's shareholders transferred all of their stock in X to two trusts. A is the sole current income beneficiary of Trust1; B is the sole current income beneficiary of Trust2.

X represents that both Trust1 and Trust2 are qualified subchapter S trusts (QSSTs) as defined in § 1361(d)(3), and it was intended that they be treated as eligible S corporation shareholders. Due to an oversight, however, A and B did not timely file elections under § 1362(d) with respect to the trusts. Consequently, X's S status terminated on Date3. When the oversight was discovered, A and B filed QSST elections with respect to the trusts, and the corporation filed a request for inadvertent termination relief under § 1362(f).

X and its shareholders represent that at the time of the transfer of the stock to Trust, they were unaware that the ownership of the shares by Trust would terminate X's S election. The shareholders further represent that the transfer of the stock to Trust was not motivated in any way by tax avoidance or retroactive tax planning. In addition, X represents that, throughout the period from Date3 until the present, all of X's shareholders (including Trust1 and Trust2) have filed their income tax returns as though valid QSST elections for Trust1 and Trust2 had been timely filed. Nevertheless, X and its shareholders have agreed to make any adjustments that the Commissioner may require consistent with treating X as an S corporation from Date3 until the present. Accordingly, X requests a ruling that the termination of its S election was inadvertent within the meaning of § 1362(f), and that X will be treated as an S corporation during the period beginning Date3 until the date that QSST elections were filed for Trust1 and Trust2, and thereafter, provided that X's S corporation election is not otherwise terminated.

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)(B) provides that, in order to be a small business corporation, a taxpayer cannot have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2)) who is not an individual.

Section 1361(d)(1) states that a QSST whose 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.

Section 1362(d)(2)(A) provides that an election to be treated as a subchapter S corporation terminates whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Under § 1362(d)(2)(B), the termination is effective on and after the date the S corporation ceases to meet the requirements of a small business corporation.

Section 1362(f), in relevant part, provides that, if (1) an election under § 1362(a) by any corporation was terminated under § 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 § 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 the 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 § 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 Date3, when X stock was transferred to Trust. We also conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f). Pursuant to § 1362(f), X will be treated as continuing to be an S corporation during the period from Date3 until QSST elections for Trust1 and Trust2 were filed, and thereafter, provided that X's S election is not otherwise terminated under § 1362(d). In addition, between Date3 and the date the QSST elections were filed, Trust1 and Trust2 will be treated as trusts described in § 1361(c)(2)(A)(i), and A and B will be treated, for purposes of § 678, as the owner of the portion of Trust1 and Trust2, respectively, that consists of X stock. If X, Trust1, Trust2, A, or B fail to treat X, Trust1, Trust2, A or B as described above, this ruling is null and void.

Except as specifically set forth above, no opinion is expressed or implied as to the federal income tax consequences of the transaction described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether the original election made by X to be treated as an S corporation was a valid election under § 1362.

This ruling is directed only to the taxpayer on whose behalf it was requested. Section 6110(k)(3) provides that it may not be used or cited as precedent. This ruling was sent to you, X's authorized representative, pursuant to a power of attorney on file with this office.

Sincerely,

Signed/ David R. Haglund

DAVID R. HAGLUND
Senior Technician Reviewer, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)