

**Internal Revenue Service**

Department of the Treasury

Number: **200042009**  
Release Date: 10/20/2000  
Index Number: 1362.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:2-PLR-101788-00

Date:

July 18, 2000

X =

Trust A =

Trust B =

A =

B =

Trustee =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to your letter dated November 17, 1999, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X is a corporation incorporated under the laws of State on Date 1. X elected to be an S corporation effective Date 2.

On Date 3, Trust A and Trust B each purchased one quarter of a share of X stock. On the subscription agreements between X and the Trustee of Trust A and Trust B, Trustee identified Trust A and Trust B as revocable grantor trusts.

On Date 4, B, the beneficiary of Trust B, died. Pursuant to the terms of Trust B, Trust B terminated on Date 4 and the X stock held by Trust B was transferred to Trust A.

Following the death of the B, it was discovered that Trust A and Trust B were mistakenly identified on the subscription agreements. Trust A and Trust B were not revocable grantor trusts but were instead intended to be qualified subchapter S trusts (QSSTs) for which timely QSST elections were not made with respect to the X stock.

Upon discovering that QSST elections should have been, but were not made with respect to the X stock, a QSST election was submitted to the appropriate Internal Revenue Service Center for Trust A effective Date 5.

Trustee of Trust A and Trust B represents that Trust A and Trust B are QSSTs within §1362(d)(2) and that Trust A and Trust B have been administered as QSSTs since their inception. Moreover, A, the beneficiary of Trust A, represents that A has included in gross income Trust A's allocable share of X's income and loss. Trustee represents that Trustee, as B's father, took responsibility for assuring that B included in gross income Trust B's allocable share of X's income and loss and that B did in fact include in gross income Trust B's allocable share of X's income and loss.

C, the president of X represents that X's officers, directors, and advisors believed Trust A and Trust B were revocable grantor trusts and that they were unaware that QSST elections were required to be filed to qualify Trust A and Trust B as shareholders of X. Thus, the circumstances resulting in X's termination were inadvertent. C represents further that the transfer of the X stock to Trust A and Trust B was not part of a plan to terminate X's S election and that X and all of its shareholders have consistently treated X as an S corporation since Date 2. 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.

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) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B), as in effect for taxable years beginning on or before December 31, 1997, provided that a "small

business corporation" 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(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(d)(1) provides that in the case of a qualified subchapter S trust (QSST) 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) and, for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1<sup>st</sup> day of the 1<sup>st</sup> 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 the termination shall be effective on and after the date of cessation.

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 consents, 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 such ineffectiveness or 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 in the corporation at any time during the period specified pursuant to § 1362(f), 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 ineffectiveness or termination, such corporation shall be treated

as an S corporation during the period specified by the Secretary.

Based solely on the representations made and the information submitted, we conclude that X's S election terminated on Date 3, under §1362(d)(2) of the Code, because the beneficiaries of Trust A and Trust B failed to timely file an election under § 1361(d)(2). We also conclude that the termination of X's S election was an inadvertent termination within the meaning of § 1362(f).

We further hold that under the provisions of § 1362(f), X will be treated as an S corporation during the period Date 3 to Date 5 and thereafter, provided that X's election to be an S corporation was valid and was not otherwise terminated under § 1362(d). From Date 3, Trust A will be treated as a trust described in § 1361(c)(2)(A)(i), and A will be treated as the owner of that portion of Trust A that consists of X stock. From Date 3 until B's death on Date 4, Trust B will be treated as a trust described in § 1362(c)(2)(A)(i), and during that period B will be treated as the owner of that portion of Trust B that consists of X stock.

Except as specifically ruled above, we express no opinion concerning the federal income tax consequences of the transactions described above under any other provision of the Code, including whether Trust A and Trust B are QSSTs under § 1361(d)(3). This ruling letter is directed only to the taxpayer who requested it and 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 X.

Sincerely yours,  
J. THOMAS HINES  
Acting Branch Chief, Branch 2  
Office of the Assistant Chief Counsel  
(Passthroughs and Special Industries)

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

cc: