

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:01-PLR-115085-00
Date:
December 8, 2000

X =

State =

Date 1=

Date 2=

Trust 1=

Trust 2=

Trust 3=

Trust 4=

Trust 5=

Trust 6=

Trust 7=

Trust 8=

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Trust 9=

Trust 10=

:

This responds to your letter dated June 15, 2000, and subsequent correspondence, requesting relief under section 1362(f) of the Internal Revenue Code.

Facts

According to the information submitted X is a corporation organized under the laws of State and made a valid S corporation election effective Date 1. The shareholders of X include: Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, Trust 9 and Trust 10 (the "Trusts"). X Stock was transferred to the Trusts on Date 2. X intended that each of the Trusts be treated as a qualified subchapter S trust (a "QSST") as defined in section 1361(d)(3). Due to an oversight, none of the Trusts' beneficiaries made timely QSST elections under section 1362(d)(2), thereby terminating X's S corporation election on Date 2. When X's counsel discovered the oversight, X submitted this private letter ruling request for inadvertent termination relief under section 1362(f) of the Internal Revenue Code.

In addition X has requested a ruling that the Trusts are eligible to hold S corporation stock. X has represented that although the Trusts do not require the current distribution of Trust income by the Trustee, all Trust income, as defined under section 643(b), has been, and in the future will be, distributed to the beneficiaries of the Trusts every year.

X represents that the transfer of stock to the Trusts and subsequent failure to file the QSST elections were not motivated by tax avoidance or retroactive tax planning. Further, X represents that from Date 2 until the present that X, the beneficiaries of the Trusts 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 section 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

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(other than an estate, other than a trust described in section 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 whose beneficiary makes an election under section 1361(d)(2) will be treated as a trust described in section 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of section 678(a)) of that portion of the QSST's S corporation stock to which the election under section 1361(d)(2) applies.

Section 1361(d)(3) defines a qualified subchapter S trust as a trust (A) the terms of which require that (i) during the life of the 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 section 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.

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

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

Section 1.1361-(j)(6)(iii)(D) provides that if a corporation's S election terminates because of a late QSST election, the corporation may request inadvertent termination relief under section 1362(f).

Section 1362(f) provides that a corporation is treated as continuing to be an S corporation during the period specified by the Secretary if (1) an election under section 1362(a) by any corporation was terminated under paragraph (2) or (3) of section 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

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during the period specified pursuant to section 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 section 1362(f) of the Code, provides, in part, 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.

Conclusions

Based solely on the facts submitted and representations set forth above, we conclude that X's S corporation election was terminated on Date 2, however, the termination was inadvertent within the meaning of section 1362(f). Therefore under section 1362(f), X will be treated as an S corporation from Date 2 and thereafter, assuming X's S corporation election is valid and is not otherwise terminated under section 1362(d). However, this ruling is contingent on the beneficiaries of the Trusts filing QSST elections, with an effective date of Date 2, 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 elections.

Further, based on the representations made, and after review of the terms of the Trusts, we conclude that the Trusts qualify as trusts described in section 1361(d)(3), and the beneficiaries will be treated under section 678 as the owner of the portion of the Trusts consisting of X stock during the period from Date 2 and thereafter. Accordingly, the shareholders of X must include their pro rata share of the separately and nonseparately computed items of X under section 1366, make any adjustments to stock basis under section 1367, and take into account any distributions made by X to

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shareholders under section 1368. If X, the Trusts, or any of X's 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. Specifically, no opinion is expressed on whether X's original election to be an S corporation was a valid election under section 1362.

This ruling is directed 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 the taxpayer and the second listed authorized 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

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