

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:1-PLR-157262-01

Date:

November 16, 2001

Legend:

X =

A =

B =

C =

D =

Trust =

State =

a =

b =

c =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Year 1 =

PLR-157262-01

This responds to a letter dated October 12, 2001, submitted on behalf of X requesting relief under section 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 Date 1. On Date 2, the shareholders of X elected to treat X as a subchapter S corporation effective Date 3. On Date 4, A died testate, survived by B, C, and D. At the time of A's death, X was owned equally by A, B, and C, each holding a shares of X stock. Under A's will, b shares of X stock owned by A was to be distributed to Trust, and the remaining c shares of X stock was to be distributed to D.

In Year 1, the trustees of Trust and the shareholders of X realized that an election to qualify Trust as an Electing Small Business Trust (ESBT) had not been made, causing the termination of X's S election on Date 5.

X represents that at all relevant times, X and its shareholders treated X as an S corporation. X and its shareholders agree to make any adjustments required by the Secretary 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 § 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 subsection (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)(v) provides that, for purposes of § 1361(b)(1)(B), trusts that may be shareholders include an electing small business trust.

Section 1361(e)(1)(A) provides that an "electing small business trust" (ESBT) means any trust if (i) such trust does not have as a beneficiary any person other than an (I) individual, (II) an estate, or (III) an organization described in paragraph (2), (3), (4), or (5) of § 170(c) or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary; (ii) no interest in such trust was acquired by purchase, and (iii) an election under this subsection applies to such trust.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be

PLR-157262-01

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 was terminated under § 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the 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 of inadvertent termination of the S election, 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 the termination, the corporation is 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 Date 5. 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 Date 5, and thereafter, and the trustees of Trust will be treated as having filed timely an ESTB election on behalf of Trust, effective Date 5,

PLR-157262-01

provided that X's S corporation election is not otherwise terminated under § 1362(d) and provided further that the trustees of Trust file an ESTB election for Trust with the appropriate service center, effective Date 5, within 60 days of the date of this letter. 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 or whether Trust is an ESBT under § 1361(e).

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.

Under a power of attorney on file in this office, a copy of this letter will be sent to your authorized representative.

Sincerely,
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