

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:PLR-107629-02
Date:
April 8, 2002

Legend:

X	=
A	=
B	=
#a	=
D1	=
D2	=
D3	=
D4	=
D5	=
D6	=
State	=
Trust A	=
Trust B	=
Trust C	=
Trust D	=
Trust E	=
Beneficiary A	=

Beneficiary B =

Dear:

This responds to your letter dated January 25, 2002, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

X was incorporated on D1 under the laws State. X elected subchapter S status, effective, D2. On D3, A and B, husband and wife owned #a shares of X. On D3, A and B transferred their shares of X stock to Trust A. X represents that Trust A qualified as a grantor trust under subpart E of Part I of subchapter J of chapter 1. On D4, A died, and the shares of X stock were transferred to Trust B and Trust C. X did not discover that Trust B and Trust C did not qualify as eligible shareholders under § 1361(c)(2), and X's S corporation election terminated on D5. On D6, B died, and the X shares were transferred to Trust D and Trust E. X represents that the Trust D and Trust E qualified as subchapter S trusts ("QSST"s) as defined in § 1361(d)(3). Due to oversights, Beneficiary A of Trust D and Beneficiary B of Trust E did not make timely QSST elections under § 1361(d)(2). When counsel discovered these oversights, X submitted this private letter ruling request.

X represents that the transfer of stock to Trust A, the following transfer of stock to Trust B and Trust C, and the subsequent failure of Beneficiary A of Trust D and Beneficiary B of Trust E to file QSST elections were not motivated by tax avoidance or retroactive tax planning. Further X represents that from D2 until the present, all of the parties believed X to be an S corporation, and filed their respective income tax returns consistently with X's status as an S corporation.

LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation", with respect to any taxable year, as a small business corporation for which an S election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of the cessation. Section 1362(d)(2)(B).

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 in 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 such 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 consequence of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that the 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.

CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election under § 1362(a) was terminated on D5. 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 from D2, and thereafter, provided that Beneficiary A of Trust D and Beneficiary B of Trust E file QSST elections with the service center, effective as of D6, within 60 days of the date of this letter. A copy of this letter should be attached to such election.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X is a valid S corporation or whether Trust D and Trust E are valid QSSTs for federal tax purposes.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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

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

cc: