

**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-123957-02  
Date:  
Aug 26 2002

Legend:

Trust =

A =

B =

X =

Y =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

Dear :

This responds to a letter dated April 5, 2002, requesting relief under § 1362(f) of the Internal Revenue Code.

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### Facts

According to the information submitted and representations therein, A and B created Trust on D1. Shares of X were contributed to Trust on D2. Additional shares of X were contributed to Trust on D3 and D4. X elected to become an S corporation on D5 and an electing small business trust election was made for Trust effective D5.

On D6, shares of Y were contributed to Trust. With regard to the shares of Y, a qualified subchapter S trust (QSST) election was made effective D6. However, due to an oversight, a QSST election was not timely made with regard to the shares of X already in Trust, thereby terminating X's S corporation election on D6. When X's counsel discovered the oversight, X submitted this private letter ruling request.

It is represented that at all relevant times, X and its shareholders treated X as an S corporation and filed all tax returns 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)(i) provides that, for purposes of § 1361(b)(1)(B), trusts that may be shareholders include a trust all of which is treated (under subpart E of part 1 of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States.

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(d)(1) provides in part that in the case of a qualified subchapter S trust 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).

Section 1361(d)(2)(B)(i) provides that an election under § 1361(d)(2) shall be made separately with respect to each corporation the stock of which is held by the trust.

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Section 1361(d)(3) provides that for purposes of § 1361(d), the term “qualified subchapter S trust” means 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 § 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.

A substantially separate and independent share of a trust within the meaning of § 663(c) shall be treated as a separate trust for purposes of §§ 1361(c) and 1361(d).

Section 1361(e)(1)(A) provides that an “electing small business trust” 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 1361(e)(1)(B) provides in part that the term “electing small business trust” shall not include any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust.

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

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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, 97<sup>th</sup> Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24; H.R. Rep. No. 826, 97<sup>th</sup> 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 D6. We also conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D6, and thereafter, provided that the beneficiary of Trust files a QSST election with an effective date of D6, with the appropriate service center 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 a QSST under § 1361(d).

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.

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

Sincerely,

**/s/ David R. Haglund**

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