

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:3 PLR-134974-02  
Date:  
October 17, 2002

**LEGEND**

Corporation =

Shareholders =

A =

B =

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Trust =

m =

State =

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to a letter dated June 25, 2002, and subsequent correspondence, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

### Facts

According to the information submitted, Corporation is incorporated under the laws of State and filed an election to be treated as an S corporation effective Date 1. On Date 2, A, a shareholder of Corporation, transferred m shares of Corporation stock to an irrevocable trust, Trust, for the benefit of B. It is represented that Trust was intended to be a qualified subchapter S trust (QSST) under § 1361(d)(3).

In Date 3, however, it was discovered that B, the beneficiary of Trust, failed to file a QSST election and that, consequently, Corporation's S election terminated on Date 2. Corporation represents that the termination of its S corporation election was inadvertent, unintended, and not the result of tax avoidance or retroactive tax planning. Corporation further represents that at all times subsequent to Date 2, Corporation has treated Trust as a QSST. Corporation and all of its Shareholders who were shareholders during the termination period consent to make any necessary adjustments consistent with the treatment of Corporation as an S corporation.

### Law and Analysis

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.

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Section 1361(b)(1)(B) provides, in part, that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not 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 1361(c)(2)(A)(i) provides that for the purposes of § 1361(b)(1)(B) 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 of the United States may be a shareholder of an S corporation.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), (A) the trust is treated as a trust described in § 1361(c)(2)(A)(i), and (B) for the purposes of § 678(a), the beneficiary of the trust is 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)(2) apply.

Section 1361(d)(2)(D) provides that a QSST election shall be effective up to 15 days and two months before the date of the election.

Section 1362(d)(2)(A) provides that an election under § 1362(a) is terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) 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); (2) the Secretary determines that the circumstances resulting in the termination were inadvertent; (3) no later than a reasonable period of time after 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 in the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in the termination, the corporation is treated as an S corporation during the period specified by the Secretary.

### Conclusion

Based on the facts submitted and the representations made, we conclude that Corporation's S corporation election terminated on Date 2 under § 1362(d)(2) when B failed to make a timely QSST election for Trust under § 1361(d)(2). We also conclude

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that the termination of Corporation's S corporation election was inadvertent within the meaning of § 1362(f). Therefore under § 1362(f), Corporation will be treated as an S corporation from Date 2 and thereafter, provided that Corporation's S corporation election is valid and is not otherwise terminated under § 1362(d).

This ruling is contingent on B filing a QSST election for Trust with an effective date of Date 2 with the appropriate service center within 60 days from the date of this ruling. A copy of this letter must be attached to the QSST election and is enclosed for this purpose.

During the period of termination, Trust will be treated as if it was a QSST. Accordingly, the Shareholders of Corporation must include their pro rata share of the separately and nonseparately computed items of Corporation under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Corporation to shareholders under § 1368. If Corporation or any of its Shareholders fail to treat Corporation as described above, this ruling will be null and void.

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion on whether Corporation is otherwise qualified to be an S corporation, or whether Trust is a valid QSST.

This ruling is directed only to the taxpayer who requested 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 with this office, we are sending the original of this letter to you and a copy to Corporation.

Sincerely yours,

/s/

Mary Beth Collins  
Senior Technician Reviewer,  
Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter  
Copy for § 6110 purposes