

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B1-PLR-143789-02
Date:
Nov 13 2002

Legend:

- X =
- A =
- Trust =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =

Dear :

This responds to the letter dated July 31, 2002, together with subsequent correspondence, submitted on behalf of X requesting relief under section 1362(f) of the Internal Revenue Code.

FACTS

You have represented that the facts are as follows: X is a corporation which made an S corporation election effective Date 1. A, a shareholder in X, died on Date 2. Upon the death of A, the shares in X were transferred to Trust.

Trust continued to hold the X stock after the 2-year period described in section 1361(c)(2)(A)(iii). Taxpayer became aware that retaining the X stock for a period exceeding 2-years was not permitted by section 1361(c)(2)(A)(iii), and that, therefore, X's subchapter S election terminated on Date 3. On Date 4, Trust transferred its shares in X to an eligible shareholder.

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X has represented that the terminating event was not the result of any tax avoidance or retroactive tax planning on the part of X or any of its shareholders. At no time did X or its shareholders wish to terminate or express an interest in terminating X's S corporation status. In addition, X and its shareholders have agreed to make adjustments, consistent with the treatment of X as an S corporation, as may be required by the Secretary.

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) defines "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 35 shareholders, (B) have as a shareholder a person (other than an estate and other than a trust described in section 1361(c)(2)) 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)(iii) allows as a shareholder of an S corporation a trust with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which the stock is transferred to it.

Section 1362(d)(2) provides that an election to be treated as a subchapter S corporation 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. The termination is effective on and after the date the S corporation ceases to meet the requirements of a small business corporation.

Because Trust continued to hold X stock after the 2-year period set forth in section 1361(c)(2)(A)(iii), Trust was not an allowable S corporation shareholder. Therefore, X ceased to be a small business corporation, and its election of S corporation status terminated on Date 3.

Section 1362(f) provides that if (1) an election under section 1362(a) by any corporation was terminated under section 1362(d)(2) or (3), (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 of the corporation at any time 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) required by the Secretary with respect to the 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.

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The committee reports accompanying the Subchapter S Revision Act of 1982 explain section 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 the termination of X's subchapter S election on Date 3 was inadvertent within the meaning of section 1362(f).

Pursuant to the provisions of section 1362(f), X will be treated as continuing to be an S corporation during the period beginning on Date 4 and thereafter, unless X's election is not otherwise terminated under section 1362(d). Except as specifically set forth above, no opinion is expressed concerning the federal income tax consequences of the above-described facts. In particular, no opinion is expressed as to whether the election to be treated as an S corporation made by X on Date 1 was a valid election under section 1362.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

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Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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

Copy for § 6110 purposes