

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

November 29, 2002

Legend

Corporation =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Trust =

A =

B =

Shareholders =

m =

n =

o =

Dear :

This letter responds to your letter dated March 19, 2002, and subsequent correspondence, written on behalf of Corporation, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

Facts

According to the information submitted, Corporation was organized in Date 1 and elected to be treated as an S corporation effective Date 2.

Prior to Date 3, A and B owned n shares of Corporation's stock as community property. On Date 3, A died. Pursuant to the terms of A's will, A's estate transferred o shares of Corporation's stock (A's community property interest) to Trust on Date 4. B is the beneficiary of Trust.

It is represented that Trust is a qualified subchapter S trust (QSST) as defined in § 1361(d)(3). Due to an oversight, B did not make a timely QSST election under § 1361(d)(2), thereby terminating Corporation's S corporation election on Date 5 (60 days after Date 4). In Date 6, Corporation discovered that a QSST election for trust was not made. Shortly thereafter, Corporation submitted this private letter ruling request.

Corporation represents that the transfer of stock to Trust and subsequent failure to file the QSST election were not motivated by tax avoidance or retroactive tax planning. It is represented that Corporation and its shareholders have treated Corporation as an S corporation since Date 2. Further, Corporation represents that since Date 5, B has been treated as the owner of the o shares of Corporation's stock that were transferred to Trust. Corporation and its shareholders have agreed to make any adjustments that the Commissioner may require consistent with the treatment of Corporation as an S corporation.

Law

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 that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1) a trust, all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States, may be a shareholder of an S corporation.

For taxable years beginning on or before December 31, 1996, § 1361(c)(2)(A)(iii) provides that a trust with respect to stock transferred to it pursuant to the terms of a will, but only for the 60-day period beginning on the day on which such stock is transferred to it, may be a shareholder of an S corporation.

Section 1361(d)(1) states that a QSST with respect to which a beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the QSST's beneficiary will be treated as the owner of that portion of the QSST that consists of stock in an S corporation to which the election under § 1361(d)(2) is made.

Under § 1361(d)(2)(A), the beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Under § 1362(d)(2)(A), 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) or (3), (2) the Secretary determines that the termination was 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 of the corporation at any time during the period specified pursuant to § 1362(f), 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 the period, then notwithstanding the circumstances resulting in the termination, such corporation is treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representations made, we conclude that Corporation's S corporation election terminated on Date 5 under § 1362(d)(2) when B failed to make a timely QSST election for Trust under § 1361(d)(2). We also conclude 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 5 and thereafter, provided that B files a QSST election for Trust, with an effective date of Date 5, with the appropriate service center within 60 days of the date of this ruling, and that Corporation's S corporation election is valid and is not otherwise terminated under § 1362(d). 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 a trust described in § 1361(c)(2)(A)(i), and B will be treated, for purposes of § 678, as the owner of that portion of Trust which consists of Corporation stock. Accordingly, the shareholders of

Corporation, in determining their respective income tax liabilities for the period beginning Date 5 and thereafter must include their pro rata share of the separately stated and non-separately computed items of Corporation under § 1366, make any adjustments to basis under § 1367, and take into account any distributions made by Corporation under § 1368. If Corporation or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed on whether Corporation is otherwise qualified to be an S corporation, or whether Trust is a valid QSST.

Pursuant to the power of attorney on file with this office, we are sending the original of this letter to you, Corporation's authorized representative, and a copy of this letter to Corporation.

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.

Sincerely yours,
/s/

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

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes