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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:3
PLR-165155-04

Date: July 14, 2005

LEGEND

X =

A =

B =

Trust1 =

Trust2 =

State =

D1 =

D2 =

D3 =

Dear :

This letter responds to a letter dated December 7, 2004, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X is an S corporation incorporated under the laws of State. X's shares were owned by Trust1, a grantor trust owned by and for the benefit of A and B.

A died on D1. Pursuant to the terms of Trust1, upon A's death, Trust1 was to allocate and distribute all of Trust1 assets among certain sub-trusts, including Trust2, a grantor trust owned by B, A's surviving spouse. Some, but not all, of the X stock was transferred from Trust1 to Trust2. Due to inadvertence, however, Trust1 continued to hold X stock after D2, the date that is two years after the date of A's death, thereby terminating X's S corporation election. On D3, after discovering the two-year period had expired, Trust1 transferred its remaining shares of X to Trust2.

X represents that there was no intention to terminate its S corporation election and that the termination was inadvertent and not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any necessary adjustments consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

Section 1362(a)(1) provides that except as provided in § 1362(g), a small business corporation may elect to be an S corporation.

Section 1361(b)(1)(B) defines a "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not, among other things, 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 purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1 of the Code) (a grantor trust) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation. Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1.1361-1(h)(1)(ii) of the Income Tax Regulations provides, in part, that a trust that was a qualified subpart E trust immediately before the death of the deemed owner and that continues in existence after the death of the deemed owner, is a permitted shareholder of an S corporation, but only for the 2-year period beginning on the day of the deemed owner's death. A trust is considered to continue in existence if the trust continues to hold stock during a period reasonably necessary to wind up the affairs of the trust.

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

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 such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such 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 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 the period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

CONCLUSIONS

Based on the facts submitted and representations made, we conclude that X's S corporation election terminated on D2, two years after the death of A. We also find that the termination was inadvertent within the meaning of § 1362(f). Under the provisions of § 1362(f), X will continue to be treated as an S corporation from D2 to D3 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d). During the termination period, Trust2 will be treated as the owner of the stock for tax purposes. The shareholders of X must include their pro rata share of the separately and nonseparately computed items of X under § 1366, make

any adjustments to stock basis under § 1367, and take into account any distributions made by X to shareholders under § 1368. If X or its shareholders fail to treat X as described above, during the period from D2 to D3, this ruling shall be null and void.

Except for the specific ruling above, no opinion is expressed or implied 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 X is otherwise qualified to be an S corporation.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

This ruling is directed only to the taxpayer requesting it. Under § 6110(k)(3), it may not be used or cited as precedent.

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

cc: