

Internal Revenue Service

Department of the Treasury

Number: **200212010**
Release Date: 3/22/2002
Index Number: 1362.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-143267-01
Date:
December 14, 2001

Company =

A =

B =

C =

Trust =

D1 =

D2 =

D3 =

D4 =

D5 =

Dear

This letter responds to your letter dated July 20, 2001, and subsequent correspondence submitted on behalf of Company, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

FACTS

On D1, Company made an election under § 1362(a). On D2, shareholder A, created Trust, a grantor trust taxed under Subpart E. When A died on D3, Trust ceased to be a grantor trust. The entire corpus of Trust was included in A's estate.

Under former § 1361(c)(2)(A)(ii) and (B)(ii), A's estate remained a shareholder until D5, two years after A's death. On D5, Trust continued to hold shares of Company's stock. C is the sole beneficiary of Trust.

On or about D4, Company hired a new accounting firm that noted a QSST election for Trust had not been filed timely. As a result of the failure to file the QSST election, Company's S corporation election terminated. Company represents that Trust has met all the requirements of a Qualified Subchapter S Trust (QSST) since its inception. Company represents that failing to file the QSST election was not part of a plan to terminate Company's S corporation election nor was it motivated by tax avoidance or retroactive tax planning. Company represents that from D1 to the present, it has operated as a S corporation, and has filed returns and issued K-1's each year to its shareholders who in turn reported the income on their personal income tax returns. Company, B, and C agree to make any adjustments (consistent with the treatment of Company as an S corporation) that may be required by the Commissioner.

LAW AND ANALYSIS

Section 1361(b)(1)(B) provides that a "small business corporation" cannot have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2) who is not an individual.

Section 1361(c)(2)(A)(i) provides that a trust, all of which is treated (under subpart E, part I, subchapter J) as owned by an individual who is a citizen or resident of the United States, is a permitted shareholder of a small business corporation.

Former § 1361(c)(2)(A)(ii) provided that a trust described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death is a permitted shareholder, but only for the 60-day period beginning on the day of the deemed owner's death. If a trust is described in the preceding sentence and if the entire corpus of the trust is includible in the gross estate of the deemed owner, the preceding sentence is applied by substituting "2-year period" for "60-day period".

Section 1361(c)(2)(B)(ii) provided that in the case of a trust described in § 1361(c)(2)(A)(ii), the estate of the deemed owner is treated as the shareholder.

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

Section 1361(d)(3) provides that 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 is only one 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 terminates on the earlier of the 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 distributes all of its assets to that beneficiary, and (B) all of the income (within the meaning of section 643(b)) which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such 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 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 agrees to make adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the termination period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that, for purposes of § 1.1362-4(a), 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 information submitted and representations made, we conclude that Company's S corporation election was terminated on D5 when the two-year period

described in § 1361(c)(2)(A)(ii) expired. We further conclude that the termination was inadvertent within the meaning of § 1362(f).

Under § 1362(f), Company will be treated as if it were an S corporation from D5 and thereafter, provided a QSST election with an effective date of D5 is filed with the appropriate service center within 60 days from the date of this letter, and Company's S corporation election was otherwise valid and not otherwise terminated under § 1362(d). Accordingly, Company's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately and nonseparately computed items of Company as provided in § 1367, and take into account any distributions made by Company as provided by § 1368. If Company, or any of the shareholders fail to treat Company as described above, this ruling shall be void. A copy of this letter should be attached to the QSST election.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether Company was and is a S corporation for federal tax purposes. Further, we express or imply no opinion concerning whether Trust meets the requirements of § 1361(d)(3).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

Under a Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,
Christine Ellison
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes