

Internal Revenue Service

Department of the Treasury

Index Number: 1362.04-00

Washington, DC 20224

Number: 199932026

Person to Contact:

Release Date: 8/13/1999

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:2 - PLR-103685-99

Date:

May 13, 1999

X =

H =

W =

President =

Trustee =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to a January 28, 1999 ruling request and subsequent correspondence submitted on behalf of X by its authorized representative requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on Date 1 and elected to be an S corporation effective Date 2. One of X's original shareholders, H, died on Date 3 owning 1,270 shares or 42.33 percent of X's stock. Decedent's will established three testamentary trusts (the Trusts). H's spouse W is the sole income beneficiary of the Trusts. Trustee represents

that the Trusts have at all times met and continue to meet the requirements of a qualified subchapter S trust (QSST) under § 1361(d)(3) of the Code. H's estate held H's X stock until Date 4, when the stock was transferred to the Trusts. W was unaware of the need to file QSST elections for the Trusts. X's accountant who is the current trustee of the Trusts discovered W's failure to file the QSST elections on or around Date 5. Immediately thereafter, X requested this ruling and W filed QSST elections with the Internal Revenue Service.

X and its shareholders have agreed to make any adjustments that the Commissioner may require due to the inadvertent termination of X's S election. The President of X represents that the terminating event was not motivated by tax avoidance or any retroactive tax planning. The President also represents that X has viewed and treated itself as an S corporation since Date 2.

Section 1361(a) of the Code 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.

Section 1361(b)(1)(B) of the Code defines the term "small business corporation" for taxable years on or before December 31, 1997, as a domestic corporation which is not an ineligible corporation and that does not 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 1362(d)(2)(A) of the Code provides that an election under § 1362(a) shall terminate 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(d)(2)(B) provides that any termination under § 1362(d)(2)(A) will be effective on and after the date of cessation.

Section 1362(f) of the Code provides that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (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 this subsection, 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 such period, then, notwithstanding the terminating event, the corporation will be treated as continuing

to be an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we hold that as a result of W's failure to timely file QSST elections, X's S election terminated the day after the 60-day period that began on the day that the stock was transferred to the Trusts. We also hold that the termination was inadvertent within the meaning of § 1362(f) of the Code.

We further hold that under the provisions of § 1362(f) of the Code, X will be treated as continuing to be an S corporation from the day of X's termination and thereafter, provided X's S corporation election was not otherwise invalid and provided that the election was not otherwise terminated under § 1362(d). In addition, from the day of X's termination and thereafter the Trusts will be treated as trusts described in § 1361(c)(2)(A)(i), and W will be treated, for purposes of § 678, as the owner of that portion of the Trusts which consist of X stock. If X or its shareholders fail to treat X and the Trusts as described above, this ruling will be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Particularly, we neither express nor imply any opinion concerning whether the Trusts are, or ever were, "qualified subchapter S trusts" within the meaning of § 1361(d)(3) of the Code.

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

Pursuant to a power of attorney on file, a copy of this letter is being sent to X.

Sincerely,

J. THOMAS HINES
Senior Technician Reviewer
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of letter
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