Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

199903049

Telephone Number:

Refer Reply To:
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Date:
October 27, 1998

Legend

X =

D1 =

D2 =

Trust =

This responds to your letter dated September 8, 1998, and subsequent correspondence, written on behalf of X, requesting a ruling that the termination of X's S corporation status was an inadvertent termination under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated on D1. Subsequent to incorporation, X made an S corporation election effective D1, that was accepted by the applicable Service Center. X has always reported as an S corporation. On D2, X stock was transferred to Trust. X represents that Trust is a qualified subchapter S trust (a "QSST") as defined in § 1361(d)(3). Due to an oversight, Trust's beneficiary did not make a timely QSST election under § 1362(d)(2), and X's S corporation election terminated on D2. When X's accountant discovered the oversight, X submitted this

private letter ruling request and obtained a QSST election by Trust's beneficiary to be filed with the Internal Revenue Service upon receiving a favorable ruling.

X represents that the QSST beneficiary's failure to file the proper election was inadvertent and not the result of tax avoidance, retroactive tax planning, or an intention to revoke X's S election. Moreover, X and its shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require for the period of termination.

LAW AND ANALYSIS

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 "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, other than a trust described in § 1361(c)(2), and other than an organization described in (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 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 subchapter S corporation shareholder.

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

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), an election to be an S corporation will be terminated whenever 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 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, such corporation is treated as continuing to be an S corporation during the period specified by the Secretary.

With respect to § 1362(f), the committee reports to the Subchapter S Revision Act of 1982 provide, in part, 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.

CONCLUSIONS

Based solely on the facts submitted and representations set forth above, we conclude that the termination of X's subchapter S election on D2 was inadvertent within the meaning of § 1362(f).

Pursuant to § 1362(f), X will be treated as continuing to be an S corporation from D2, and thereafter, unless X's election is otherwise terminated.

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 X's original election to be an S corporation was a valid election under § 1362 or whether Trust is a QSST within the meaning of § 1361(d)(3).

This ruling is directed only to the taxpayer who 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 in this office, a copy of this letter will be sent to X.

Sincerely,

DANIEL J. COBURN
Assistant to the Branch Chief, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

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