

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:  
February 11, 1999

LEGEND

Company =

Shareholder =

Trusts =

d1 =

d2 =

d3 =

d4 =

d5 =

x =

Dear

This letter responds to a letter dated August 11, 1998, and subsequent correspondence, submitted by your authorized representative on behalf of Company, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

#### FACTS

According to the information submitted, Company was incorporated on d1 and filed an election to be an S corporation effective d2. On d3, Shareholder, Company's sole shareholder, transferred x shares of Company's stock to the Trusts. Company and the beneficiaries of the Trusts represent that each of the trusts satisfies all of the requirements under § 1361(d)(3) to be qualified subchapter S trusts (QSSTs). However, because of a mistake by Company's attorneys, the Trusts' beneficiaries did not file QSST elections, as required by § 1361(d)(2). Thus, Company's S corporation election terminated on d3. Shortly after discovering that its S corporation election had terminated, Company filed for § 1362(f) inadvertent termination relief.

Company represents that all of its shareholders have filed their returns in a manner consistent with Company's treatment as an S corporation, and with the Trusts as QSSTs, and that the failure to file timely QSST elections was not for a tax avoidance purpose. Company and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of Company 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 for the taxable year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not 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 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 for purposes of § 1361(b)(1)(B).

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

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or the beneficiary's legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) may be effective up to 15 days and two months before the date of the election.

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

Section 1362(d)(2)(B) provides that a termination of an S corporation election is 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 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 under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

## CONCLUSIONS

After applying the relevant law to the facts submitted and the representations made, we conclude that (1) Company's S corporation election was terminated on when Shareholder transferred Company stock to the Trusts; (2) the termination was dadventent within the meaning of § 1362(f); (3) no later than a reasonable period after

discovery of the terminating event, steps were taken to acquire the required

shareholder consents; and (4) no tax avoidance was intended or will result from the continued treatment of Company as an S corporation. Therefore under § 1362(f), Company will be treated as an S corporation from d3 and thereafter, assuming Company's S corporation election is valid and is not otherwise terminated under § 1362(d). However, this ruling is contingent on the beneficiaries of the Trusts filing QSST elections with the appropriate service center within 60 days of the date of this ruling with an effective date of d5. A copy of this letter must be attached to each QSST election.

If the Trusts file a QSST election with an effective date of d5 with the appropriate service center within 60 days from the date of this ruling, the Trusts will be treated as trusts described in § 1361(c)(2)(A)(i), and the respective beneficiary of each Trust will be treated under § 678 as the respective owner of the portion of each trust consisting of Company stock during the period from d3 until d5 and thereafter assuming the Trusts satisfy the QSST requirements. Accordingly, the Shareholders of Company must include their pro rata share of the separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company to shareholders under § 1368. If Company, the Trusts, or any of Company's shareholders fail to treat Company as described above, this ruling will 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, no opinion is expressed regarding whether Company is otherwise qualified to be an S corporation, or whether the Trusts are otherwise qualified to be QSSTs.

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

Under a power of attorney on file in this office, a copy of this letter will be sent to your authorized representative.

Sincerely Yours,

Jeff Erickson  
Assistant to the Branch Chief,  
Branch 3  
Office of the Assistant Chief  
Counsel  
( Passthroughs and Special  
Industries)

Enclosures (2)

Copy of this letter  
Copy for § 6110 purposes