Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-120305-04
Date:
July 16, 2004

In Re:

Legend:

X =

Trust A =

Trust B =

State =

Date 1 =

Date 2 =

Dear :

This letter is in response to your request, dated April 8, 2004, on behalf of X, seeking inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

Facts

Based on the materials submitted and representations within, we understand the relevant facts to be as follows. X was incorporated on Date 1 in accordance with the laws of State. X made an election to be treated as an S corporation effective Date 2. Some of the stock of X was held by Trust A and Trust B that both elected qualified subchapter S trust (QSST) treatment, effective Date 2. Following the elections, the trusts distributed income to the beneficiaries only to the extent necessary to pay taxes.

Trust A and Trust B did not realize that failing to distribute all income annually would terminate their QSST status and thereby, terminate X's S corporation election.

Law and Analysis

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

Section 1361(a)(1) defines a 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.

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 a corporation is treated as continuing to be a S corporation during the period specified by the Secretary 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 terminating event, 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 § 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 that period.

Section 1.1362-4(b) of the Income Tax Regulations 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.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24, in discussing section 1362(f) of the Code, provides, 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.

Conclusion

Based on the information submitted and the representations made, we conclude that X's S corporation election terminated, as a result of the failure to distribute current income to the beneficiaries. We further conclude that such a termination was inadvertent within the meaning of § 1362(f) of the Code. Consequently, we rule that X will be treated as continuing to be an S corporation from Date 2 thereafter, provided that the respective beneficiaries of the Trusts receive all income owed to them from the Trusts, and that X's S election otherwise is not terminated under § 1362(d).

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the facts described above under any other provision of the code. In particular, no opinion is expresses or implied as to whether X otherwise qualifies as a subchapter S corporation under § 1361.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling will be sent to the taxpayer.

Sincerely,

David R. Haglund
General Attorney, Branch 1
(Passthroughs & Special Industries)