

Internal Revenue Service

Department of the Treasury

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Date:

September 16, 1999

X =

A =

B =

C =

Trust =

Y =

Dear :

This is in reply to your letter dated May 12, 1999, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated in 1940 and elected to be an S corporation effective June 1, 1991. On March 27, 1996, Y shares of X were transferred to Trust from the estate of A pursuant to the terms of A's will. C, as X's president, represents that Trust was a qualified subchapter S trust (QSST) under § 1361(d)(3) of the Code. However, B, the income beneficiary of Trust, failed to timely file an election under § 1361(d)(2) (QSST election). B was unaware of the requirement to file a QSST election. B relied upon B's advisors for assistance in all tax and legal matters. Each advisor, however, thought one of the other advisors had prepared and filed the QSST election. B died on September 7, 1998.

In December 1998, upon examination of the share ownership

records of X, X's counsel discovered that it did not have a copy of a QSST election with respect to Trust. Subsequently, X confirmed no such election was filed.

C represents that the failure to file the QSST election with respect to Trust and the related termination of the S corporation election were inadvertent. Additionally, C represents that the failure to file the election was not motivated by tax avoidance. C further represents that X and its shareholders have treated X as an S corporation at all applicable times since the initial S corporation election.

X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) 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.

For taxable years beginning on or before December 31, 1997, § 1361(b)(1)(B) of the Code provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which 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.

For taxable years beginning on or before December 31, 1996, § 1361(c)(2)(A)(iii) provides that a trust, with respect to stock transferred to it pursuant to the terms of a will, but only for the 60-day period beginning on the day on which such stock is transferred to it, may be a shareholder. Section 1361(c)(2)(B)(iii) provides that in the case of a trust described in § 1361(c)(2)(A)(iii), the estate of the testator shall be treated as the shareholder.

Section 1361(c)(2)(A)(i) of the Code provides that for purposes of § 1361(b)(1)(B), 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. Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(d)(1) of the Code provides that in the case of a qualified subchapter S trust (QSST) with respect to which a beneficiary makes an election under § 1361(d)(2), such trust

shall be treated as a trust described in § 1361(c)(2)(A)(i) and, for purposes of § 678(a), the beneficiary of such trust shall be 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 § 1361(d)(2) is made.

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

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2)(A) provides that an election to be an S corporation terminates whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, 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 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 circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted, and the representations

made, we conclude that, as a result of B's failure to timely file a QSST election, X's S corporation election terminated on May 26, 1996, the day after the 60-day period that began on the day that X stock was transferred to Trust. We also conclude that this termination was inadvertent within the meaning of § 1362(f).

We further hold that under the provisions of § 1362(f) of the Code, X will be treated as continuing to be an S corporation, provided that X's S corporation election was valid and that the election was not otherwise terminated under § 1362(d). In addition, from May 26, 1996, until the date of B's death, Trust will be treated as a trust described in § 1361(c)(2)(A)(i) and B will be treated, for purposes of § 678, as the owner of that portion of the trust consisting of X stock. Therefore, the shareholders of X must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling shall 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, including whether Trust was a QSST under § 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.

In accordance with the power of attorney on file with this office, we are forwarding a copy of this letter to X.

Sincerely yours,

H. GRACE KIM  
Assistant to the Chief  
Branch 2  
Office of the Assistant  
Chief Counsel  
(Passthroughs and  
Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes

