

## Internal Revenue Service

Department of the Treasury

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### LEGEND

Company =

A =

B =

Trust =

Year =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

m =

This responds to a letter dated December 2, 1999, together with subsequent correspondence, written on behalf of Company, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

### FACTS

Company was incorporated in Year, and elected to be an S corporation effective D1. On D2, Trust was formed by A, a shareholder of Company. On D3, A transferred

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m shares of Company stock to Trust. Trust was completely revocable until A's death on D4. Company's S election terminated because the beneficiary of Trust failed to make a timely election under section 1361(d)(2) to treat Trust as a qualified subchapter S trust (QSST).

On D5, it was discovered that no election had been filed for Trust to be treated as a QSST. Upon further investigation, it also was discovered that Trust did not meet the eligibility requirements for a QSST. On D6, B (as trustee for Trust) petitioned the court of appropriate jurisdiction to reform the Trust, and the court subsequently issued an order granting B's petition. Company represents that Trust, as reformed, is eligible to be treated as a QSST.

Company represents that at all relevant times, Company and its shareholders treated Company as an S corporation. Company and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of Company as an S corporation. Further, Company represents that the termination of Company's S status was not motivated by tax avoidance or retroactive tax planning.

#### LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, for any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

As of D4, § 1361(b) defines the term "small business corporation" to mean a domestic corporation that is not an ineligible corporation and that does not (A) have more than 35 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock. Under § 1361(d), a QSST (defined in § 1361(d)(3)) may be treated as an eligible shareholder described in § 1361(c)(2)(A)(i).

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

Section 1362(f) provides, in part, 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 the 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 pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as

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may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

After applying the relevant law to the facts submitted and the representations made, we rule that the termination of Company's subchapter S corporation election, as described above, was an inadvertent termination within the meaning of § 1362(f). Under the provisions of § 1362(f), Company will be treated as continuing to be an S corporation from D4, and thereafter, provided that Company's S corporation election was valid and was not otherwise terminated under § 1362(d), and that B files a QSST election, effective D8, with the appropriate Service Center within 60 days of the date of this letter.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the foregoing facts. Specifically, we express no opinion on whether Company'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 requesting it. Under § 6110(k)(3), 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 is being sent to Company.

Sincerely yours,  
David R. Haglund  
Senior Technician Reviewer, Branch 1  
Office of the Assistant Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)  
Copy of this letter  
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