

Dear

This letter responds to a letter dated February 5, 2003, and subsequent correspondence, written on behalf of X, requesting inadvertent termination relief under section 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X, a domestic entity, was incorporated under the laws of State on D1. Thereafter, X elected subchapter S status, effective D2. On D3, A, X's sole shareholder, transferred shares of non-voting common stock of X to Trust 1 and Trust 2. At the time of the transfer X, A, Trust 1, Trust 2, Beneficiary # 1 and Beneficiary # 2 (jointly referred to as "the beneficiaries") relied on their accountant to file the necessary papers to ensure the validity of X's S corporation election, including without limitation the proper preparation and filing of the Qualified Subchapter S Trust (QSST) election for Trust 1 and Trust 2. Sometime in D4, X, A, Trust 1, Trust 2 and the beneficiaries hired a new accountant. After reviewing the documents associated with this transaction, the new accountant discovered that the QSST elections were not timely filed.

X, A, Trust 1, Trust 2 and the beneficiaries represent that at no time did they desire X's S corporation election to be terminated. X, A, Trust 1, Trust 2 and the beneficiaries have agreed to make any adjustments that the Commissioner of the Internal Revenue Service may require.

LAW AND ANALYSIS

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

Section 1361(b)(1)(B) provides that a "small business corporation" cannot have as a shareholder a person (other than an estate, a trust described in subsection 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that a trust, all of which is treated as owned by an individual who is a citizen or resident of the United States, is a permitted shareholder of a small business corporation.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under section 1361(d)(2), such trust shall be treated as a trust described in section 1361(c)(2)(A)(i), and for purposes of section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust

consisting of stock in an S corporation with respect to which the election under section 1361(d)(2) is made.

Under section 1361(d)(2)(A), the beneficiary of a QSST may elect to have section 1361(d) apply. Under section 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Under section 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 an S corporation during the period specified by the Secretary if (1) an election under section 1362(a) by any corporation was terminated under paragraph (2) or (3) of section 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 section 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.

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, states in part:

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 was terminated on D3, as a result of the transfer of X stock to Trust 1 and Trust 2 without a timely QSST election having been filed on their behalf. However, we conclude that such termination was inadvertent within the meaning of section 1362(f). Consequently we rule that X will be treated as an S corporation from D3 and thereafter, provided that the respective beneficiaries of Trust 1 and Trust 2 file QSST elections within 60 days of the date of this letter, and that X's S election otherwise is not terminated under section 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 expressed or implied as to whether X otherwise qualifies as a Subchapter S corporation under section 1361 or whether Trust 1 or Trust 2 qualifies as a QSST.

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, a copy of this letter is being sent to the taxpayer and the second authorized representative indicated on the taxpayer's Power of Attorney.

Sincerely,

/s/ Dan Carmody
Dan Carmody
Special Counsel, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for section 6110 purpose