

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B1-PLR-109829-00
Date:
April 26, 2001

Legend:

X =

A =

Trust =

State =

D1 =

D2 =

D3 =

D4 =

D5 =

This responds to a letter dated May 4, 2000, together with subsequent correspondence, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code.

FACTS

X was incorporated under State law. Effective D1, X elected to be treated as a subchapter S corporation.

A owned shares of X stock. On D2, A died. Upon A's death, the X stock was transferred to Trust. The administration of A's estate and of Trust were closely related. For reasons detailed in the ruling request, administration of A's estate was delayed. Two years after A's death, on D3, Trust still held shares of X stock.

In D4, while reviewing Trust, counsel for Trust discovered that Trust continued to hold X stock for more than two years after A's death and that as a result, X's S corporation election had terminated. Shortly after this discovery, on D5 X represents that the Trust trustee distributed the shares of X stock held by Trust to an eligible S corporation shareholder.

Neither X nor its shareholders were aware that as of D3 Trust no longer was an eligible S corporation shareholder. From D3 to D5, X and its shareholders treated X as an S corporation. There was no plan by X or any of its shareholders to terminate X's election.

LAW AND ANALYSIS

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

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

Section 1361(c)(2)(A)(i) provides that a trust, all of which is treated (under subpart E, part I, subchapter J, chapter 1) 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(c)(2)(A)(ii) provides that, for purposes of section 1361(b)(1)(B), a trust that was described in section 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death, is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

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

Section 1362(f), in relevant part, provides that, if: (1) an election under section 1362(a) by any corporation was terminated under section 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 such termination, steps were taken so that the corporation is a small business corporation; and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, 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 termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

The committee reports accompanying the Subchapter S Revision Act of 1982, in discussing section 1362(f) as it relates to inadvertent terminations, state, 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 the 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 [*8] the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24.

CONCLUSIONS

Based solely on the facts submitted and representations made, we conclude that X's subchapter S election terminated on D3 when the two-year period described in section 1361(c)(2)(A)(ii) expired. We also conclude that the termination was an inadvertent termination within the meaning of section 1362(f). Under the provisions of section 1362(f), X will be treated as an S corporation from D3 and thereafter, provided that X's S corporation election is not otherwise terminated under section 1362(d).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether the original election made by X to be treated as an S corporation was a valid election under section 1362.

This ruling is directed only to the taxpayer(s) requesting 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 your authorized representative.

Sincerely,
/s/Dianna K. Miosi
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes