Internal Revenue Service

Department of the Treasury

Number: **200047026**
Release Date: 11/24/2000
Index Number: 1362.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-109747-00
Date:
August 23, 2000

Company:

Trust:

State:

M:

N:

a:

b:

c:

d:

e:

f:

Dear

This letter responds to your letter dated May 3, 2000, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code that the termination of Company's S corporation election was inadvertent. Company represents the following facts.

Company was incorporated under the laws of State on a and elected under § 1362(a) to be an S corporation effective b.

Trust was created on c for the benefit of M, a minor. N, the parent of M, is Trust's current trustee. N elected under § 1361(d)(2)(A) to have the qualified

subchapter S trust (QSST) rules apply to Trust effective b.

Company's S election terminated on d when N failed to make the Trust income distribution for e, as required by § 1361(d)(3)(B).

Company's accountant, in conjunction with Company's S corporation election, prepared election statements for both an electing small business trust (ESBT) and a QSST, intending that N select one of the forms. Upon receipt of the election statements, N signed both forms, not realizing the difference between the two. Company represents, however, that it was N's intention that Trust not be required to make annual distributions and that it therefore be an ESBT and not a QSST.

N's secretary, also not knowing the difference between the two executed forms, sent the QSST election statement to the accountant and placed the ESBT election statement in N's files for Trust. The accountant filed the QSST election with the Internal Revenue Service. The Company represents, however, that the accountant believed that Trust had made an ESBT election.

N made no distributions from Trust for e, believing that no distributions were required. On or about f, the accountant, while preparing Company's tax return, realized that the QSST election statement had been filed with the Service and not the ESBT statement.

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that a trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation for purposes of § 1361(b)(1)(B). Section 1361(c)(2)(B)(i) provides that, 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) provides that, in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2)–

(A) the trust shall be treated as a trust described in § 1361(c)(2)(A)(i), and
(B) for purposes of § 678(a), the beneficiary of the 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) 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 1361(d)(3) provides that, for purposes of § 1361(d), the term "qualified subchapter S trust" means a trust-

(A) the terms of which require that–

(i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust,
(ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary,
(iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust, and
(iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary, and

(B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(5) of the Income Tax Regulations provides that if a QSST ceases to meet the income distribution requirement specified in § 1.1361-1(j)(1)(i) [§ 1361(d)(3)(B)], but continues to meet all of the requirements in § 1.1361-1(j)(1)(ii) [§ 1361(d)(3)(A)], the provisions of § 1.1361-1(j) [the QSST rules] will cease to apply as of the first day of the first tax year beginning after the first tax year in which the trust ceased to meet the income distribution requirement. If a corporation's S election is inadvertently terminated as a result of a trust ceasing to meet the QSST requirements, the corporation may request relief under § 1362(f).

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in 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 might be required by the Secretary regarding this period, then, notwithstanding the circumstances resulting in termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that 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.

According to the legislative history of § 1362(f)--

> 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.

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

Company represents that tax avoidance was not a motive for any of the actions described in its ruling request and that the termination of its S corporation election resulted solely because the wrong election statement was filed for Trust. The Company intended at all times to retain its S corporation status.

After applying the applicable law and regulations to the facts and representations of this ruling request, we conclude that the termination of Company's S corporation election due to N's failure to make the required income distribution from Trust was

inadvertent within the meaning of § 1362(f).

Consequently, we rule that Company will be treated as continuing to be an S corporation from d to the present, unless Company's S election otherwise is terminated under § 1362(d). As a condition for this ruling, N must make the Trust income distribution for e, as required by § 1361(d)(3)(B), within 60 days of the date of this ruling letter.

The ruling in this letter is based on information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding Company's eligibility to be an S corporation or Trust's qualifications as a QSST.

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

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,
ROBERT HONIGMAN
Acting Assistant to the Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes