

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:DOM:P&SI:1-PLR-104640-99  
Date:  
June 06, 1999

Legend:

X =

TrustA =

A =

TrustB =

B =

D1 =

State =

This responds to the letter dated February 12, 1999, submitted on behalf of X requesting relief under § 1362(f) of the Internal Revenue Code.

**FACTS**

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You have represented that the facts are as follows. X is a corporation organized under the laws of State which made a valid S corporation election effective D1. As of D1, X had 24 shareholders: 21 individuals, one grantor trust, and two trusts, TrustA and TrustB, for which Qualified Subchapter S Trust elections (QSST) were made. A is the sole income beneficiary of TrustA and B is the sole income beneficiary of TrustB. A and B are the co-trustees of TrustA and TrustB.

The trust documents pertaining to TrustA and TrustB do not require that all of the income of each trust be distributed annually. Due to oversight by the trustees of TrustA and TrustB, not all of the income of TrustA and TrustB was actually distributed to the respective beneficiary of each trust for the corporation's first S corporation taxable year and the following calendar year, however, all of the income of each trust was reported on each respective beneficiary's individual income tax return for both taxable years. After discovering the oversight, the remaining undistributed income of each trust was distributed to each beneficiary and the trustees initiated procedures to ensure conformity with the need to distribute S corporation income in the future.

## LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation" as "a small business corporation for which an election under § 1362 is in effect."

Section 1361(b)(1)(B) provides that, in order to be a small business corporation, a taxpayer cannot 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.

Section 1361(d)(1) states that a QSST whose beneficiary makes an election under §1361(d)(2) will be treated as a trust described in §1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of §678(a)) of that portion of the QSST's S corporation stock to which the election under §1361(d)(2) applies.

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

Section 1362(d)(2)(A) provides that an election to be treated as a subchapter 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) such corporation ceases to be a small business corporation. Under §1362(d)(2)(B), the termination is effective on and after the date the S corporation ceases to meet the requirements of a small business corporation.

Section 1362(f), in relevant part, provides that, if (1) an election under §1362(a) by

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any corporation was terminated under § 1362(d), (2) the Secretary determines that the termination was inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in the termination, 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 § 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 the period, then, notwithstanding the terminating event, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

The committee reports accompanying the Subchapter S Revision Act of 1982 explain §1362(f) 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 waive, 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, 97<sup>th</sup> Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24; H.R. Rep. No. 826, 97<sup>th</sup> Cong., 2d Sess. 12 (1982), 1982-2 C.B. 730, 735.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's election to be treated as an S corporation terminated when the trustees of Trust A and Trust B failed to distribute all of the income of the trusts to A and B, respectively. We also conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f). Pursuant to § 1362(f), X will be treated as continuing to be an S corporation from D1 to the date of this ruling, and hereafter, provided that X's S election is not otherwise terminated under § 1362(d).

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Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. 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 § 1362.

This ruling is directed only to the taxpayer 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,

**Signed/Dianna K. Miosi**

Dianna K. Miosi  
Chief, Branch 1  
Office of the Assistant Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)  
Copy of this letter  
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