

Internal Revenue Service

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Person To Contact:

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Date:

June 25, 2004

X =

A =

Trust =

Court =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

D7 =

Dear

This responds to a letter dated February 18, 2004, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1. X elected to become an S corporation, effective D2. At the time the S corporation election was filed, the shareholders of X consisted of twelve individuals and Trust. Trust was a grantor trust that was treated (under subpart E of part 1 of subchapter J of chapter 1) as entirely owned by A, a citizen of the United States. Therefore, Trust was eligible to be an S corporation shareholder under § 1361(c)(2)(A)(i). Before its amendment, the trust agreement for Trust provided that upon A's death, Trust was to transfer one-sixth of the shares of X held in Trust to each of A's six children. Trust was to transfer these shares outright to five of A's six children and a new trust was to be created to hold the sixth child's shares. The new trust was to be a qualified subchapter S trust that had a corporate trustee.

When A died on D3, Trust ceased to be a grantor trust. Under § 1361(c)(2)(A)(ii), Trust remained an eligible S corporation shareholder until D4, two years after A's death. The trustee of Trust was delayed in distributing the shares of X held by Trust because the trustee was unable to find a corporate trustee for the new trust to be created for A's sixth child. The trustee of Trust was unaware that Trust would no longer be an eligible S corporation shareholder upon the expiration of the two year period following A's death. On D4, Trust continued to hold shares of X stock.

In D5, an attorney settling the affairs of Trust discovered that X's S election had terminated on D4. Immediately after this discovery, the trustee of Trust sought a court order modifying the terms of Trust to permit distribution of the shares of X stock to all of the individual beneficiaries free of trust. An Order Amending Trust Agreement was entered by Court on D6. The shares of X held by Trust were distributed to the six individual beneficiaries of Trust effective D7.

X represents that the circumstances resulting in the termination of X's S election to be an S corporation were inadvertent. X also represents that X and X's shareholders did not intend to engage in tax avoidance or retroactive tax planning. X and each person who was or is a shareholder of X at any time since D4 agree to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

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 § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not 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 for purposes of section 1361(b)(1)(B), a trust may be a shareholder if all of it is treated (under subpart E of part I of subchapter J

of chapter 1 of title 26) as owned by an individual who is a citizen or resident of the United States.

Section 1361(c)(2)(A)(ii) provides that for purposes of section 1361(b)(1)(B), a trust which was described in section 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which 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(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

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

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 such 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 under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that 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.

Based solely on the facts and the representations made, we hold that X's election to be an S corporation effective D2 terminated on D4 as a result of the failure of Trust to timely distribute the shares it held in X. We hold also that the termination of X's S corporation election was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation from D4 through D7 and afterwards, provided that X's S election was valid and was not otherwise terminated under § 1362(d).

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express no opinion regarding whether X is otherwise eligible to be an S corporation.

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.

Under a power of attorney on file with this office, we are sending a copy of this letter to X's representative.

Sincerely yours,

Beverly Katz
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2

Copy of this letter

Copy of § 6110 purposes