

**Internal Revenue Service**

Department of the Treasury

Number: **200121033**  
Release Date: 5/25/2001  
Index Number: 1362.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:1-PLR-102134-01  
Date:  
February 21, 2001

Legend:

X =

Trust =

a% =

State =

D1 =

D2 =

D3 =

This responds to your letter dated December 27, 2000, submitted on behalf of X requesting relief under section 1362(f) of the Internal Revenue Code.

**FACTS**

According to the information submitted, X incorporated under the laws of State on D1. X filed an election to be treated as a subchapter S corporation, effective D2, which was accepted by the applicable Service Center. At the time X filed the election to be treated as an S corporation, X's shareholders included Trust, an ineligible S corporation shareholder owning a% of X shares. Because Trust was an ineligible S corporation shareholder, X's election to be treated as an S corporation was ineffective. Upon discovery that Trust was an ineligible shareholder, X redeemed all of Trust's shares in X on D3. X and its shareholders then requested inadvertent invalid election relief under section 1362(f) of the Code.

X represents that at all relevant times after D2, X and its shareholders treated X as an S corporation. X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

**LAW AND ANALYSIS**

PLR-102134-01

Section 1361(a)(1) defines an "S corporation" as "a small business corporation for which an election under section 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, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual.

Section 1361(c)(2)(A) of the Code provides that five types of domestic trusts may be shareholders of an S corporation: (i) a trust all of which is treated (under subpart E of part I of subchapter J) as owned by an individual who is a citizen or resident of the United States; (ii) a trust which was described in clause (i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death; (iii) a trust with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which such stock is transferred to it; (iv) a trust created primarily to exercise the voting power of stock transferred to it; and (v) an electing small business trust.

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 section 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 section 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, (2) the Secretary determines that circumstances resulting in the ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in ineffectiveness, 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 the period, then, notwithstanding the circumstances resulting in the ineffectiveness, 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 section 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

PLR-102134-01

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. 12-13 (1982), 1982-2 C.B. 718, 723-24;  
H.R. Rep. No. 826, 97th 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 invalid election was inadvertent within the meaning of section 1362(f). Therefore, pursuant to section 1362(f), X will be treated as a subchapter S corporation beginning on D2 and thereafter, provided that X's subchapter S election is not otherwise terminated under section 1362(d). During the period from D2 to D3, Trust will be treated as a shareholder of X.

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 otherwise a valid election under section 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.

PLR-102134-01

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 taxpayer's second authorized representative.

Sincerely,

**/s/David R. Haglund**

Senior Technician Reviewer, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes