

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2-PLR-101135-03
Date:
July 16, 2003

X =

A =

B =

C =

Trust1 =

Trust2 =

D1 =

D2 =

D3 =

D4 =

Dear :

This letter responds to a letter dated December 24, 2002, submitted on behalf of X by its authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

A, the president of X, represents that X elected to be an S corporation effective D1. A further represents that B and C, shareholders of X, created Trust1, a wholly-owned grantor trust and permitted shareholder of X, on D2. B and C, his wife, transferred their shares of X stock to Trust1 at the formation of the trust or shortly thereafter. Following the death of B, Trust1 divided into three separate trusts. On D3, stock of X was transferred from Trust1 to two of the three new trusts created upon the

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death of B. A represents that one of these trusts qualified as a wholly-owned grantor trust and a permitted shareholder of X. The other trust, Trust2, was intended to qualify as a Qualified Subchapter S Trust (QSST). However, C, the beneficiary of the Trust2 did not know, and the accountants and attorneys advising C did not inform C, of the need to file the election required under §1361(d)(2). On D4, all the shareholders of X were advised of the failure to file the QSST election for Trust2 and the resultant termination of X's S corporation election. The shareholders advised the accounting firm to prepare the request for relief. This request for relief under § 1362(f) was subsequently submitted.

A represents that the failure to file the QSST election was not motivated by tax avoidance or retroactive tax planning. C represents that C has filed C's federal income tax return consistent with the treatment of Trust2 as a QSST. The shareholders of X represent that they have filed their federal income tax returns consistent with the treatment of X as an S corporation since D1. The shareholders of X also represent that they had no control over, or knowledge of, the events that led to the termination of X's election to be an S corporation. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) of the Code 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 the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not 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(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1) provides that in the case of a QSST for which a beneficiary makes an election under § 1361(d)(2), the trust is treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of the trust shall be treated as the owner of that portion of the trust that 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 may elect to have that section apply.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax returns

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the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents; 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 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 the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on D3 when Trust2, an ineligible S corporation shareholder, acquired X stock. We also conclude that the termination was inadvertent within the meaning of § 1362(f).

We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D3 and thereafter, provided X's S corporation election was otherwise valid and provided that the election was not terminated under § 1362(d). Trust2 will be treated as a trust described in § 1361(c)(2)(A)(i), and C will be treated for purposes of § 678 as the owner of the portion of the trust which consists of X stock. The shareholders of X must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

This ruling is conditioned upon C filing an appropriately completed QSST election effective D3, with the appropriate service center within 60 days following the date of this letter. A copy of this letter should be attached to the election.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. In particular, we express no opinion on whether Trust2, is, or ever was, a QSST

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within the meaning of § 1361(d)(3).

This ruling is directed only to the taxpayer that requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely yours,

J. Thomas Hines
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes

cc: