

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2-PLR-136686-02
Date:
October 25, 2002

Legend

X =

A =

B =

Trust =

n =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear :

This letter responds to a letter dated May 30, 2002, together with subsequent correspondence, submitted on behalf of X requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

X was formed by A and B on Date 1 and timely filed a subchapter S election effective on Date 2. On Date 3, A died. On Date 4, pursuant to A's will, A's estate transferred n shares of X stock to Trust. The income beneficiary of Trust, B, intended to file an election for Trust to be treated as a "qualified subchapter S trust" ("QSST") under § 1361(d). However, the income beneficiary of Trust failed to file the required election.

Since Date 4, all of X's shareholders have reported their share of X's income as though X were an S corporation and B has included Trust's share of income items in B's personal returns. X and its shareholders have agreed to make any adjustments that are required by the Secretary consistent with the treatment of X as an S corporation. X represents that there was no intent to terminate X's S election, and that the failure to file a timely QSST election was not motivated by tax avoidance or retroactive tax planning.

Law and Analysis

Section 1361(a)(1) defines an "S corporation" with respect to any taxable year, as a small business corporation for which an election under § 1362(a) is in effect for that year.

Section 1361(b)(1)(B) provides that the term "small business corporation" is 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) or an organization described in 1361(c)(6)) 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(c)(2)(B)(i) provides that for purposes of 1361(b)(1), in the case of a trust described in 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(c)(2)(A)(iii) provides that 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, may be a shareholder in an S corporation.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1362(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), a 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 1361(d)(3) defines a QSST as 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 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 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 paragraph (2) or (3) of 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person 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 such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's subchapter S election terminated upon the expiration of the 2-year period beginning on Date 4. We also conclude that the termination was an inadvertent termination within the meaning of § 1362(f). Under the provisions of § 1362(f), X will be treated as an S corporation from the date of termination and thereafter, provided that X's S corporation election is not otherwise terminated under § 1362(d).

This ruling is contingent on X and all of its shareholders treating X as having been an S corporation for the period beginning on Date 4, and thereafter. Accordingly, the shareholders of X must include their pro rata share of the separately stated and non-separately computed items of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. Furthermore, this ruling is contingent on B filing a QSST election with the appropriate service center, effective Date 4, within 60 days from the date of this letter. A copy of this letter should be attached to the QSST election. Provided this

election is made, Trust will be treated as a QSST, and B will be treated for purposes of § 678(a), as the owner of that portion of Trust containing X stock.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. 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 or whether Trust is a QSST.

This ruling is directed only to the taxpayer(s) 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 X.

Sincerely,

Matthew Lay
Senior Technician Reviewer, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2

Copy of this letter

Copy for §6110 purposes