

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:2 - PLR-144900-02

Date:

August 27, 2003

X =

A =

B =

Trust A =

Trust B =

Trust C =

D1 =

D2 =

D3 =

D4 =

Dear :

This letter responds to a letter, dated July 20, 2002, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1 and elected to

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be a subchapter S corporation effective D2. On D3, A died. On D4, shares of X stock were transferred to Trust A, Trust B, and Trust C (the Trusts). B, the president of X, represents that the Trusts were intended to be qualified subchapter S trusts (QSSTs). Additionally, B represents that the Trusts meet all of the requirements to elect to be treated as QSSTs under § 1361(d)(3). However, the beneficiaries of the Trusts did not make timely QSST elections under § 1361(d)(2) which resulted in the termination of X's S election on D4.

B represents that all of X's shareholders have filed their Federal income tax returns consistent with X's treatment as an S corporation and that the transfer of X stock to the Trusts and the subsequent failure to file QSST elections was not motivated by tax avoidance or retroactive tax planning. X and X's shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require for the period of termination.

Section 1361(a)(1) of the Code defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable 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 § 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(d)(1) provides that in the case of a qualified subchapter S trust (QSST) with respect to which a beneficiary makes an election under § 1361(d)(2), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which 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 (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated

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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); (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.

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

Based solely on the facts and representations submitted, we hold that X's S election terminated on D4 under § 1362(d)(2), because the respective beneficiaries of the Trusts failed to timely file an election under § 1361(d)(2). We also conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to § 1362(f), X will be treated as continuing to be an S corporation from D4 and thereafter, provided that the election was otherwise valid and 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 D4 and thereafter. Accordingly, 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 provided in § 1367, and take into account any distributions made by X as provided in § 1368. In addition, from D4 and thereafter, each of the Trusts will be treated as QSSTs described in § 1361(d)(3), and the respective beneficiaries of each Trust will be treated as the respective owners of the X stock held by the Trusts provided that the respective beneficiaries of the Trusts file a QSST election effective D4 for each Trust with the appropriate service center within 60 days following the date of this letter. If X or its shareholders fail to treat X as described above, this ruling will be null and void. A copy of this letter must be attached to the QSST elections.

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

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the Code, including whether X was or is a small business corporation under § 1361(b) or whether the Trusts are otherwise valid QSSTs.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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's authorized representative.

Sincerely yours,

AUDREY W. ELLIS  
Reviewer, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

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