

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:

July 13, 2004

LEGEND

Company =

Trust =

Beneficiary =

Decedent =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear :

This letter responds to a letter dated June 12, 2003, submitted on behalf of Company requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

Company was incorporated and elected S corporation status under § 1362(a) on Date 1.

On Date 2, Decedent, a U.S. citizen, created a revocable Trust. Decedent's shares of Company stock were transferred to the Trust. On Date 3, Decedent died and Trust became an irrevocable trust which continued to hold the shares of Company stock. Beneficiary, a U.S. citizen, is the sole income beneficiary of Trust. It is represented that the terms of Trust possess all the elements of a qualified subchapter S trust (QSST) as defined in § 1361(d)(3).

In June of , Company discovered that a QSST election was never filed. Company, Beneficiary, and the trustee of Trust were not aware of the failure to file a QSST election. At all times since Decedent's death, Company, Beneficiary and the Trust represent that they intended that the shares of Company stock be held in a trust that was a permitted S corporation shareholder.

Company represents that the termination of its S corporation election was inadvertent. Company further represents that at all times subsequent to Decedent's death, Company and its shareholders have treated Company as an S corporation. In addition, Company and its shareholders agree to make such adjustments, consistent with the treatment of the corporation as an S corporation, as may be required by the Service. Company and Beneficiary also represent that Trust satisfies the requirements in § 1361(d)(3) to be a QSST. In addition, Trust and Beneficiary agree to make such adjustments, consistent with the treatment of the trust as a QSST, as may be required by the Service.

Company requests a ruling for relief from the inadvertent termination of its S corporation status under § 1362(f).

LAW

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under § 1362(a) is in effect for the 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, 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 of an S corporation.

Section 1361(c)(2)(A)(ii) provides that for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after the death, is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(d)(1) provides that in the case of a 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 1361(d)(3) provides that a QSST means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only 1 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 income beneficiary in the trust shall terminate on the earlier of such 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 such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

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)(A) provides that an election under § 1362(a) terminates whenever the corporation ceases to be a small business corporation.

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 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 such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based on the information submitted and the representations made, Trust was an eligible S corporation shareholder under § 1361(c)(2)(A)(i) before Date 3. After Date 3, Trust was an eligible S corporation shareholder under § 1361(c)(2)(A)(ii) for the 2 year period beginning on Date 3. Accordingly, we conclude that Company's S corporation election was terminated on Date 4, when the two year period after Decedent's death ended and Trust became an ineligible shareholder. We further conclude that this termination was inadvertent within the meaning of § 1362(f). Thus, under the provisions of § 1362(f), Company will be treated as an S corporation from Date 4, and thereafter, provided that the beneficiary of Trust files a QSST election with an effective date of Date 4 within 90 days following the date of this letter with the appropriate service center and provided that Company's S corporation election is valid and is not otherwise terminated under § 1362(d). A copy of this letter should be attached to the QSST election.

During the termination period and thereafter, Trust will be treated as if it was a QSST described in § 1361(c)(2)(A)(i), and Beneficiary will be treated, for purposes of § 678, as the owner of Trust. Accordingly, Beneficiary must include Trust's pro rata share of the separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company to Trust under § 1368. The shareholders of Company also must include their pro rata share of the separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company to the shareholders under § 1368. If Company, Trust, Beneficiary, or any of Company's other shareholders fail to treat Company as described above, this ruling will be null and void.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provisions of the Code. Specifically, we express or imply no opinion concerning whether Company is otherwise qualified to be an S corporation or whether Trust is otherwise qualified to be a QSST.

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

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.

Sincerely,

/s/

Christine Ellison
Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes