

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:2

PLR-125728-06

Date:

September 19, 2006

Legend

X:

A:

Trust 1:

Trust 2:

Trust 3:

b:

c:

Date 1:

Date 2:

Date 3:

Date 4:

Date 5:

Dear _____ :

This responds to a letter dated May 17, 2006, and additional correspondence submitted on behalf of X by its authorized representative, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated in Date 1, and elected to be treated as an S corporation effective Date 2. On Date 3, A transferred X stock to Trust 1 with b separate shares for A's b children. On Date 4, A transferred X stock to Trust 2 with b separate shares for b of A's grandchildren. On Date 5, A transferred X stock to Trust 3 with c separate shares for c of A's grandchildren. Trust 1, Trust 2 and Trust 3 (collectively the Trusts) were each intended to satisfy the requirements of a QSST as described in § 1361(d)(3). However, each of the current income beneficiaries of the separate shares of each of the Trusts failed to elect to treat its respective separate share as a qualified subchapter S trust (QSST). Therefore, X's S election terminated on Date 3. The failure to file the QSST elections was discovered when A's accountant was reviewing the tax filings for the Trusts.

Each of the trust beneficiaries represents that his or her failure to file QSST elections was inadvertent and that the termination of X's S corporation status was not motivated by tax avoidance or retroactive tax planning. Additionally, X and the beneficiaries of the separate shares of Trust 1 represent that they have filed federal income tax returns consistent both with the treatment of the Trusts as QSSTs effective as of the Trusts' respective dates of formation and X as an S corporation. X and each person who was a shareholder of X during the S corporation termination period agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

Section 1361(a)(1) 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, 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(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under section 1361(d)(2)—(A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, (B) 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 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).

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

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

Based solely on the representations made and the information submitted, we conclude that X's S corporation election terminated on Date 3, under § 1362(d)(2), because the beneficiary of each separate share of Trust 1 failed to file a QSST election, and that this termination of X's S election was an inadvertent termination within the

meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 3 through Date 5 and thereafter, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d) (excluding the failure of the beneficiaries of the separate shares of the Trusts to file QSST elections). All of X's shareholders in determining their respective income tax liabilities during the termination period, must include their pro rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and nonseparately computed income or loss 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.

This ruling is conditioned upon the filing of completed QSST elections for each separate share of Trust 1, Trust 2 and Trust 3 effective Date 3, Date 4 or Date 5, as the case may be, with the appropriate service center within 60 days following the date of this letter. A copy of this letter should be attached to the QSST elections. If X or X's shareholders fail to treat X as described above, this ruling will be null and void.

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 X was or is a small business corporation or whether the Trusts are otherwise eligible to be QSSTs.

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

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

Sincerely,

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

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