

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:3 / PLR-156277-05

Date:

September 29, 2006

Company:

Shareholders:

Trusts:

Beneficiaries – A:

B:

C:

D:

a:

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b:c:d:e:f:g:

Dear _____ :

We received a letter from your authorized representative dated November 2, 2005, and subsequent correspondence, submitted on behalf of Company, requesting rulings under § 1362(f) of the Internal Revenue Code. This letter responds to that request.

FACTS

Company elected under § 1362(a) to be an S corporation effective a. Shareholders of Company include the Trusts, which were intended to be qualified subchapter S trusts (QSSTs). In b, in the process of having its c Form 1120S (U.S. Income Tax Return for an S Corporation) prepared, Company discovered that QSST elections had not been made when filing its Form 2553 (Election by a Small Business Corporation). QSST elections for the Trusts, signed by the parents of Beneficiaries, were filed that same month under Rev. Proc. 2003-43, 2003-1 C.B. 998. In preparing the ruling request under § 1362(f), Company discovered that Beneficiaries C and D were not minors at the time their parents signed the QSST elections.

In d, Company became aware that for tax years e the Trusts failed to distribute to Beneficiaries all trust income, as required by § 1361(d)(3)(B). The Trusts distributed the trust income balances for e in f.

Company represents that the failure to make the required distributions or to have the adult beneficiaries sign the QSST elections was inadvertent and was not motivated by tax avoidance, nor was there any intent to terminate Company's S corporation election.

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Company and its Shareholders agree to make any adjustments during the termination period (consistent with the treatment of Company as an S corporation) as might be required by the Service.

LAW

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

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.

In the case of a QSST with respect to which a beneficiary makes an election under section 1361(d)(2), § 1361(d)(1) provides that (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 1361(d)(3)(B) provides that the term QSST means a trust 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 1361(d)(4)(B) provides that if any QSST ceases to meet any requirements of § 1361(d)(3)(B), but continues to meet the requirements of § 1361(d)(3)(A), the provision of § 1361(d) shall not apply to such trust as of the first

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day of the first taxable year beginning after the first taxable year for which it failed to meet the requirements of § 1361(d)(3)(B) .

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 for which the election was made or the termination occurred is a small business corporation, or (B) to acquire the required shareholder consents; and (4) the corporation for which the election was made or the termination occurred, 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.

In Ann. 97-4, 1997-3 I.R.B. 14, the Service informed taxpayers that, in general, in order to obtain relief for inadvertent invalid elections, a corporation must request a private letter ruling. The rules under section 1.1362-4(c) through (f) for corporations requesting inadvertent termination relief also apply to corporations requesting inadvertent invalid election relief.

Section 1.1362-4(b) provides that the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was

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not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based on the facts and representations submitted, we conclude that Company's ineffective S corporation election due to the failure of Beneficiaries C and D to make QSST elections was inadvertent within the meaning of § 1362(f) (Company represents that the failure of Beneficiaries A and B to make such elections was corrected pursuant to Rev. Proc. 2003-43). In addition, we conclude that the termination of Company's election on g because of the failure of the Trusts to distribute all trust income to Beneficiaries, had Company's election not been ineffective due to the absence of QSST elections, would have been inadvertent within the meaning of § 1362(f). Consequently, we rule that Company will continue to be treated as an S corporation from a, and thereafter, unless Company's S election otherwise terminates under § 1362(d).

As conditions for this ruling—

1) Beneficiaries C and D each must file a QSST election as prescribed by § 1.1361-1(j)(6), with an effective date of a, within 60 days of the date of this ruling letter; a copy of this letter must be attached to each election; and

2) each Shareholder, in determining its income tax liability for the termination period and thereafter, must take into account its prorata share of the separately stated items and nonseparately computed income and loss of Company as provided in § 1366, make any adjustments to stock or debt basis as provided in § 1367, and take into account any distributions by Company as provided in § 1368.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied regarding Company's eligibility to be an S corporation or regarding the eligibility of the Trusts to be QSSTs.

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Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

/s/

CHRISTINE ELLISON
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy of this letter
copy for § 6110 purposes

cc :