

## 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:

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CC:PSI:B03  
PLR-156462-06  
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October 26, 2007

## LEGEND

X =

Decedent =

Beneficiary =

Trust =

State =

D1 =

D2 =

D3 =

D4 =

D5 =

Dear :

We received the letter dated December 4, 2006, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code. This letter responds to that request.

### FACTS

X was incorporated under the laws of State on D1. X elected to be treated as an S corporation under § 1362 effective D1.

Decedent, X's majority shareholder, died on D2. On D3, pursuant to Decedent's Last Will and Testament, all of Decedent's shares of X stock were transferred to Trust. Beneficiary was the sole income beneficiary of Trust. X represents that at all times Trust satisfied the requirements to be treated as a qualified subchapter S trust ("QSST") under § 1361(d). However, no election under § 1361(d)(2) to treat Trust as a QSST was filed. Therefore, X's S corporation election terminated two years after D3, on D4. Beneficiary reported Beneficiary's allocable share of Trust's income consistent with the treatment of Trust as a QSST on all affected returns.

On D5, Trust was dissolved, and the Trust assets were conveyed in their entirety to Beneficiary. At this time, X's professional advisors discovered that a QSST election had not been filed.

X represents that the failure to file a QSST election for Trust was not motivated by tax avoidance or retroactive tax planning. X and all of its shareholders consent and agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary under § 1362(f).

### LAW

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, in part, 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(c)(2)(A)(iii) provides that, for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will may be a shareholder, but only for the 2-year period beginning on the day on which such stock is transferred to it.

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), the trust is treated as a trust described in § 1361(c)(2)(A)(i) and, for purposes of § 678(a), the beneficiary of the trust is 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 qualified subchapter S trust (or his legal representative) may elect to have § 1361(d)(1) 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 returns the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means 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 income 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(a) provides, in part, that a small business corporation may elect to be an S corporation.

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

Section 1362(f) provides, in part, 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 such termination, steps were taken so that the corporation is a small business corporation, 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 the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

### CONCLUSION

Based on the information submitted and representations made, we conclude that X's S corporation election terminated under § 1362(d)(2) on D4, when Trust became an ineligible shareholder. We further conclude that this termination was inadvertent 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 D4 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d). Trust will be treated as a QSST from D4 until its termination. All of X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately and non-separately computed items 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 by § 1368. This ruling is contingent upon Beneficiary filing a QSST election for Trust with an effective date of D4, 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 election. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

Except as specifically ruled above, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be treated as an S corporation or whether Trust is eligible to be a QSST under § 1361(d)(3).

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

Pursuant to a Power of Attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

Sincerely,

/s/

Tara P. Volungis  
Senior Technician Reviewer, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes