

## Internal Revenue Service

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Department of the Treasury

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Date of Communication: Not Applicable

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PLR-138604-07

Date: February 7, 2008

### Legend:

X =

State =

D1 =

D2 =

A =

Trust =

D3 =

B =

Year 1 =

Year 2 =

D4 =

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Dear :

This responds to the letter dated August 6, 2007, and related correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code ("Code") for an inadvertent termination of an S corporation election.

### FACTS

The information submitted states that X was incorporated under the laws of State and has been an S corporation for federal tax purposes since D1. On D2, A, a shareholder of X, transferred her interest in X to Trust, a grantor trust. On D3, A passed away. A's surviving spouse, B, became the trustee and beneficiary of Trust.

Although X and its shareholders never intended the S election of X to terminate, B was not aware of the necessity of filing a qualified subchapter S trust (QSST) election and, therefore, did not file a QSST election on behalf of Trust. Further, even though the trust agreement requires that Trust be administered in conformity with QSST rules, B was not aware of the requirement and, consequently, distributed Trust income to someone other than himself as the current income beneficiary of Trust in Year 1 and Year 2.

Upon the discovery of the errors, X and its shareholders took corrective action. X and its shareholders have also agreed to make any adjustments the Commissioner may require consistent with the continuing treatment of X as an S corporation, on and after D4.

### LAW AND ANALYSIS

Section 1361(a)(1) 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 cannot 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 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 an S corporation shareholder.

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

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owner and which continues in existence after such death, may be an S corporation shareholder, but only for the two year period beginning on the day of the deemed owner's death.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), thereby, an eligible shareholder of an S corporation, and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1362(d)(2) applies.

Section 1361(d)(3) defines the term "qualified Subchapter S trust" as 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 beneficiary, the trust shall distribute all 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(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of cessation. § 1362(d)(2)(B).

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 consent, 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 the 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 this subsection, 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 termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

### CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S election terminated on D4, upon the expiration of the two-year period following the death of A. We also conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f).

Further, we conclude that, pursuant to § 1362(f), X will be treated as continuing to be an S corporation from D4 and thereafter, assuming X's S election is valid and not otherwise terminated under § 1362(d).

This ruling is contingent upon X and all its shareholders treating X as having been an S corporation and Trust as a QSST for the period beginning D4, and thereafter. Within 60 days from the date of this letter, the beneficiary of Trust must elect to treat Trust as a QSST, effective D4, with the appropriate service center. Copies of this letter should be attached to the elections. If these conditions are not met, then this ruling is null and void.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code, including whether X was otherwise a valid S corporation, or whether Trust was otherwise a valid QSST.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code 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 ruling will be sent to your authorized representative.

Sincerely,

/s/

Dianna K. Miosi  
Chief, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter  
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