

shareholder. Trust qualified as a permissible S corporation shareholder under § 1361(c)(2)(A)(iii) for the two-year period beginning on D3. On D4, Trust became an ineligible shareholder of X. As a result, X's election to be an S corporation terminated. X represents that Trust has, at all times since the transfer of X's stock to Trust, met the requirements of a qualified subchapter S trust (QSST), within the meaning of § 1361(d)(3). However, the beneficiary of Trust failed to timely file an election under § 1361(d)(2) for Trust to be a QSST. X further represents that it did not intend for its S corporation election to terminate and the termination was not motivated by tax avoidance. Finally, X and its shareholder agree to make any adjustments required by the Secretary consistent with the treatment of X as 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) defines a "small business corporation" as a domestic corporation which is not an ineligible shareholder and which does not (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

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)(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 is a permitted 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 a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), 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 a QSST as 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 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 (with 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(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (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 termination, steps were taken so that the corporation is once more a small business corporation, 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 any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the termination, the corporation will be treated as continuing to be an S corporation during the period specified by the Secretary.

Based solely on the information submitted and the representations made, we conclude that X's S election terminated on D4 when Trust became an ineligible S corporation shareholder, and that the termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation from D4, and thereafter, provided that X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d) and provided that the following conditions are met. As an adjustment under § 1362(f)(4), a payment of \$n and a copy of this letter must be sent to the following address: Internal Revenue Service, Cincinnati Service Center, 201 West Rivercenter Blvd., Covington, KY 41011, Stop 31, Terri Lackey, Manual Deposit. This payment must be sent no later than D5. In addition, the beneficiary of Trust must file a QSST election effective D4 with the appropriate service center within 60 days of the date of this letter. A copy of this letter should be attached to the QSST election.

Accordingly, the shareholder of X must include in its income its pro rata share of separately stated and nonseparately 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 in § 1368. This ruling is contingent upon X and its shareholder filing any amended returns and making such adjustments that are necessary to properly reflect the reporting of X's items of S corporation income. Additionally, Trust and Trust's beneficiary must file any amended returns and make adjustments that are necessary to properly reflect the treatment of Trust as a QSST.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

If all of the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the appropriate service center that its S corporation election has terminated.

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

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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