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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:B01

PLR-128388-10

Date:

December 29, 2010

X =

State =

Grantor =

Wife =

Trust1 =

Trust2 =

Trust3 =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

Dear

This responds to a letter dated July 2, 2010, submitted on behalf of X, by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that X was incorporated under the laws of State on Date1 and elected to be treated as an S corporation effective Date2. Grantor was the sole shareholder of X at the time of the election.

Grantor formed Trust1 on Date3 and transferred all of the shares of X to Trust1 on Date4. The governing document of Trust1 provides that during Grantor's life, Grantor had the absolute right to amend, restate, or revoke any term or provision of the trust agreement. In addition, Grantor had the absolute right to control the distribution of income and principal from the trust. This included the right to direct distributions of income and principal to himself.

Grantor died on Date5. Upon Grantor's death, the governing document of Trust1 provides that the trust property was to be held by Trust1 during a reasonable period of administration, after which the trust property, including the X stock, was to be distributed to Trust2 and Trust3. In accordance with the trust document, X stock was transferred to Trust2 and to Trust3 on Date6.

Trust2 and Trust3 were intended to be qualified subchapter S trusts (QSSTs). During Wife's life, Wife was the sole beneficiary of Trust2 and Trust3. It has been represented that Trust2 and Trust3 distributed all of their income to Wife.

X represents that Trust2 was eligible to be treated as a QSST. However, Wife inadvertently failed to make a timely QSST election under § 1361(d)(2).

X represents that Trust3 was eligible to be treated as a QSST except that the trust document granted Wife a lifetime limited power of appointment over the principal of Trust3. On Date7, Wife disclaimed her lifetime power of appointment over the principal of Trust3 effective Date6. In addition, Wife failed to make a timely QSST election for Trust3 under § 1361(d)(2).

Wife died on Date8 and the shares of X stock were treated as distributed to an individual who is an eligible S shareholder as of that date.

As a result of the transfer of the X stock to Trust2 and Trust3, X's S election terminated on Date6. X represents that the presence of the ineligible shareholders and the termination of its S corporation election was inadvertent and not motivated by tax avoidance. X and its shareholders agree to make such adjustments, consistent with the treatment of X as an S corporation as may be required by the secretary.

LAW AND ANALYSIS

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) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation 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 one class of stock.

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 1 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)(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 owner and which continues in existence after such death, may be a shareholder for the 2-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) and the beneficiary of such trust shall be treated as the owner (for purposes of § 678(a)) 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) 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 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(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(f) provides, in part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (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 for which the termination occurred is a small business corporation; and (4) the corporation for which 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 termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the information submitted and the representations made, we conclude that Trust1 was a permitted shareholder in X, under § 1361(c)(2)(A)(i) from Date4 to Date 5 and a permitted shareholder under § 1361(c)(2)(A)(ii) from Date5 to Date6.

We further conclude that X's S corporation election terminated on Date6 as a result of the transfer of X stock to Trust2 and Trust3. We also conclude that the termination of X's status as an S corporation 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 Date6, and thereafter, provided that X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d). Trust2 will be treated as QSST from Date6 and thereafter. Trust3 will be treated as a QSST from Date7 and thereafter.

This relief is contingent upon a QSST election being filed for Trust2 with an effective date of Date6 with the appropriate service center within 120 days following the date of this letter. A copy of this letter should be attached to the QSST election. A QSST election must be filed for Trust3 with an effective date of Date7 with the appropriate service center within 120 days following the date of this letter. A copy of this letter should be attached to the QSST election. Wife must be treated as the shareholder of the X stock for the purpose of §§ 1366, 1367, and 1368 during the period that Trust2

and Trust3 held the stock. X and its shareholders must also file any necessary original or amended returns consistent with the relief granted within 120 days following the date of this letter.

Except as expressly provided herein, no opinion is express or implied 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 an S corporation for federal tax purposes.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Faith P. Colson

Faith P. Colson
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: