

Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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X =

A =

B =

D1 =

D2 =

D3 =

D4 =

D5 =

State =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

Dear _____ :

This responds to a letter dated July 19, 2011, and subsequent correspondence submitted on behalf of X by X's authorized representative, requesting that the Service grant relief under § 1362(f) of the Internal Revenue Code for inadvertent termination of an S corporation election.

The information submitted states that X was incorporated in State on D2 and elected to be an S corporation effective on D1. On D3, A created Trust1, Trust2, Trust3, and Trust4 (Trusts) funding them with cash. X represents that Trusts were grantor trusts under §§ 671-678. A died on D4. On D5, Trusts purchased X stock from B in exchange for promissory notes. X made annual or more frequent distributions to Trusts which, in turn, made payments to B in amounts necessary to pay the promissory notes.

X represents that Trusts have met the qualified subchapter S trust (QSST) requirements under § 1361(d)(3) at all times since and including D5. X also represents that Trusts reported all X income as if Trusts were QSSTs since and including D5. However, the beneficiaries of Trusts failed to make the elections under § 1361(d)(2).

X represents that the circumstances resulting in the ineffective election and termination of X's S corporation election were inadvertent and not motivated by tax avoidance. X further represents that X and its shareholders have filed all returns consistent with X's status as an S corporation. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

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 a "small business corporation" means a domestic corporation that is not an ineligible corporation and that 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 may be a shareholder if all of it 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.

Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

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), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, 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 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the QSST 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 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 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 termination of the trust during the life of the current income beneficiary, the trust shall distribute all of 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 1.1361-1(j)(2)(iv) provides, in part, that if the income beneficiary transfers or assigns the income interest or a portion of the income interest to another, the trust may no longer qualify as a QSST, depending on the facts and circumstances, because the transferee of the current income beneficiary's income interest and any person treated as a beneficiary under § 1.643(c)-1 will be treated as a current income beneficiary and the trust may no longer meet the QSST requirements.

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 it was 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 were inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in the ineffectiveness, 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 § 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, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, X's S corporation election was ineffective as of D2, because the election effective date was D1 when X was not incorporated until D2. We conclude that X's ineffective election was inadvertent within the meaning of 1362(f). In addition, had X's S corporation election been valid, it would have terminated on D5 under § 1362(d)(2) when the Trusts purchased X stock, because of the failure of Trusts beneficiaries to make the QSST elections. We conclude that this termination of X's S election was inadvertent within the meaning of § 1362(f). Furthermore, we conclude that payments from Trusts to B in amounts necessary to pay the promissory notes did not terminate X's S corporation election. Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from D2 and thereafter, provided X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d).

This ruling is contingent upon beneficiaries of Trusts filing appropriately completed QSST elections for Trusts with an effective date of D5. The QSST elections for Trusts must be filed with the appropriate service center within 120 days of the date of this ruling. A copy of this letter should be attached to each of the QSST elections. If X or its shareholders fail to treat X as described above, this letter ruling will be null and void.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was a small business corporation under § 1361(b), or whether Trusts are QSSTs within the meaning of § 1361(d)(3).

This ruling is directed only to the taxpayer who requested 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, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Charlotte Chyr
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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