

Internal Revenue Service

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Person To Contact:
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Telephone Number:

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Date:
April 06, 2012

Legend:

X =

State =

D1 =

D2 =

A =

Trust 1 =

D3 =

Trust 2 =

Trust 3 =

B =

D4 =

D5 =

Dear :

This responds to the letter dated November 1, 2011, and related correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code (A Code) for an inadvertent termination of X's S election.

FACTS

The information submitted states that X was organized under the laws of State on D1. X elected to be treated as an S corporation, effective D2. A was treated as the owner of Trust 1, a permitted shareholder of X under § 1361(c)(2)(A)(i). A died on D3. Pursuant to the terms of the trust document of Trust 1, after A's death, the assets of Trust 1 were divided and held by Trust 2 and Trust 3 respectively. B is the sole beneficiary of both Trust 2 and Trust 3. On D5, shares of X stock were transferred to Trust 2 and Trust 3.

X and its shareholders were unaware that Trust 2 and Trust 3 were ineligible shareholders of X and did not intend the S election of X to terminate. X and its shareholders represent that Trust 2 and Trust 3 qualify as Qualified subchapter S Trusts (QSSTs) under § 1361(d)(3), but B was not aware of the necessity of QSST elections and, therefore, did not timely file the elections on behalf of Trust 2 and Trust 3, effective D4. Further, after A's death, all income of the trusts were distributed to B and reported on B's income tax returns.

Immediately after the discovery of the error, X and its shareholders took remedial action. In addition, X and its shareholders agree to make any adjustments required by the Commissioner consistent with the treatment of X as an S corporation.

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 1362(a) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

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 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, but only for the 2-year period beginning on the day of the deemed owner's death, may be an S corporation shareholder.

Section 1361(d)(1) provides, in part, 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.

Under § 1361(d)(2)(A), a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this section will be effective up to 15 days and 2 months before the date of the election.

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, in part, 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 consents, 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 ineffectiveness or 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 ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust (or his legal representative) must make the QSST election by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(j)(7)(i) provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely upon the facts submitted and the representations made, we conclude that X's S election terminated on D4. We further conclude that the termination of X's S election constituted an inadvertent termination within the meaning of § 1362(f).

Under § 1362(f), X will be treated as an S corporation on D4, and thereafter, provided that X's S election was otherwise valid and has 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 2 and Trust 3 as QSSTs for the period beginning D4, and thereafter. Within 120 days from the date of this letter, the beneficiary (or his legal representatives) of Trust 2 and Trust 3 must elect to treat Trust 2 and Trust 3 as QSSTs, effective D4, respectively, with the appropriate service center. A copy of this letter should be attached to each election. 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 eligible to be an S corporation, or whether Trust 2 and Trust 3 were otherwise eligible to be QSSTs.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling will be sent to each of your authorized representatives.

Sincerely,

David R. Haglund

David R. Haglund
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes

cc: