

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

May 5, 1999

X =

A =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Trust 10 =

Estate =

D1 =

D2 =

D3 =

Year 1 =

Year 2 =

Dear :

This letter responds to the letter dated October 15, 1998 , and subsequent correspondence submitted by X's authorized representative on behalf of X, requesting relief for a late election to be an S corporation and for late elections under § 1361(d)(2).

The information submitted states that X was incorporated on D1 of Year 1. As of D2 of Year 1, the beginning of X's first taxable year, the shares of X were held by Estate, certain trusts, including Trusts 1 through 10, and four individuals. A, as X's president, represents that each of Trusts 1 through 10 qualifies as a qualified subchapter S trust (QSST) as described in § 1361(d)(3). A also represents that the shareholders intended that X elect to be an S corporation beginning Year 1, its first taxable year. X relied on X's attorneys to complete the steps necessary for X to be an S corporation. However, X's attorneys, who prepared a Form 2553, Election by a Small Business Corporation, for X failed to file the form and the related elections under § 1361(d)(2) for each of Trusts 1 through 10. X

therefore failed to timely file a Form 2553 and the respective beneficiary of each of Trusts 1 through 10 failed to file an election under § 1361(d)(2).

In late Year 2, X's accountants requested copies of Form 2553 and the related elections under § 1361(d)(2) for Trusts 1 through 10. At that time it was determined that the Form 2553 and the elections under § 1361(d)(2) had not been filed. X requested that the accountants take steps to obtain relief for the missed filings. In D3, elections under § 1361(d)(2) were filed for Trusts 1 through 10.

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. A represents that the failure to file timely elections under § 1361(d)(2) of the Code was not motivated by tax avoidance or the result of retroactive tax planning. X also represents that it and all of its shareholders have reported their income consistent with X being an S corporation since X's inception.

Section 1361(a)(1) of the Code 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) of the Code, as in effect for taxable years beginning on or before December 31, 1997, provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2)) who is not an individual.

Section 1361(c)(2)(A)(i) of the Code provides that for purposes of § 1361(b)(1)(B), 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 a shareholder.

Section 1361(d)(1) of the Code provides that in the case of a qualified subchapter S trust 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 1361(d)(2)(A) of the Code 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 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the 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 a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(b)(5) of the Code provides that if -- (A) an election under § 1362(a) is made for any taxable year after the date prescribed by § 1362(b) for making such election for such taxable year or no such election is made for any taxable year, and (B) the Secretary determines that there was reasonable cause for the failure to timely make such election, the Secretary may treat such an election as timely made for such taxable year.

Section 1362(f) of the Code provides that if (1) an election under § 1362(a) by any corporation 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 was terminated under paragraph (2) or (3) of § 1362(d), (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 such 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 § 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 or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts and the representations submitted, we conclude that X has established reasonable cause for failing to make a timely election to be an S corporation for X's first taxable year. Accordingly, provided that X makes an election to be an S corporation by filing a completed Form 2553 with the appropriate service center effective for its Year 1 taxable year,

within 60 days following the date of this letter, then such election will be treated as timely made for X's Year 1 taxable year. A copy of this letter should be attached to the Form 2553.

In addition, we conclude that X's intended S corporation election would have been ineffective because the respective beneficiary of each of Trusts 1 through 10 failed to timely file an election under § 1361(d)(2), therefore causing X to fail to meet the requirements of § 1361(b).

We further conclude that the ineffectiveness was inadvertent within the meaning of § 1362(f). Pursuant to § 1362(f), X will be treated as an S corporation from D2 of Year 1, and thereafter, provided X files a completed Form 2553, as set forth above, and X's S corporation election is not otherwise invalid and is not terminated under the provisions of § 1362(d). From D2 of Year 1, Trusts 1 through 10 will be treated as trusts described in § 1361(c)(2)(A)(i), and the respective beneficiary of Trusts 1 through 10 will be treated, for purposes of § 678, as the owner of that portion of the respective trust that consists of X stock. The shareholders of X must, in determining their federal income tax liabilities, include their respective shares of the separately and non-separately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling letter 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 or is a small business corporation under § 1361(b) of the Code.

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, copies of this letter are being forwarded to X's authorized representatives.

Sincerely yours,

H. GRACE KIM
Assistant to the Chief
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
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