

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:2 - PLR-144610-02

Date:

February 11, 2003

Legend

X =

Trust =

A =

B =

D1 =

D2 =

D3 =

Dear _____ :

This letter responds to a letter dated August 8, 2002, and subsequent correspondence, submitted by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

X was incorporated on D1 and elected to be a subchapter S corporation effective D2. On D3, A died and stock of X was transferred to Trust. X represents that Trust qualifies as a subchapter S trust (QSST) as defined in § 1361(d)(3). However, B, the beneficiary of Trust, was not aware that a QSST election needed to be made. Therefore, B did not make a timely QSST election under § 1361(d)(2), which resulted in the termination of X's S election on D3.

X represents that all of its shareholders have filed their returns in a manner consistent with X's treatment as an S corporation and that the transfer of X stock to Trust and the subsequent failure to file the QSST election was not motivated by tax avoidance or retroactive tax planning and for all taxable years Trust has reported consistent with Trust being a QSST with B as the beneficiary. X and its shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require for the period of termination.

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" 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(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 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 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (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 the termination, steps were taken so that the corporation is 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 under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the 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 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).

Based solely on the facts and representations submitted, we hold that X's S election terminated on D3 as a result of B failing to timely file a QSST election for Trust. We also conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to § 1362(f), X will be treated as continuing to be an S corporation from D3 and thereafter provided that the election was otherwise valid and is not otherwise terminated under § 1362(d).

This ruling is contingent on X and all of its shareholders treating X as having been an S corporation for the period beginning on D3 and thereafter. Accordingly, the shareholders of X must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. In addition, from D3 and thereafter, Trust must be treated as a trust described in § 1361(c)(2)(A)(i) and B must be treated, for purposes of § 678, as the owner of that portion of Trust consisting of X stock. If X or its shareholders fail to treat X as described above, this ruling will be null and void. This ruling is also contingent on B filing a QSST election, with an effective date of D3, with the appropriate service center within 60 days of the date of this ruling. A copy of this letter must be attached to the QSST election.

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) or whether Trust is otherwise a valid QSST.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, copies of this letter is being sent to X's authorized representatives.

Sincerely yours,

J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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