

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-120679-03
Date:
September 17, 2003

X =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

A =

B =

C =

D =

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State =
m =
n = _____
d1 =
d2 =
d3 =
d4 =
d5 = ____
d6 =

Dear :

This letter responds to a letter dated March 17, 2003, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

The information submitted provides that X was incorporated on d1 in State and elected to be an S corporation effective d2. X represents that its four shareholders, Trust 1, Trust 2, Trust 3, and Trust 4, qualify as qualified subchapter S trusts (QSSTs). A, B, C, and D are the income beneficiaries of Trust 1, Trust 2, Trust 3, and Trust 4, respectively.

On d3, a new trustee was appointed for Trust 1, Trust 2, Trust 3, and Trust 4. Subsequently, the new trustee discovered that the original trustee of Trust 1, Trust 2, Trust 3, and Trust 4, and not the beneficiaries or their legal representatives, signed the S corporation election and the QSST elections and that, consequently, X's S corporation election was ineffective.

X represents that since d2, X, Trust 1, Trust 2, Trust 3, and Trust 4 have filed their income tax returns as if X was an S corporation. However, on d4, C and D, the beneficiaries of Trust 3 and Trust 4, respectively, amended their individual income tax

returns for the d5 taxable year to treat Trust 3 and Trust 4 in a manner inconsistent with the QSST elections. As a result of the amended returns, C received a refund of m and

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D received a refund of n. On d6, C and D filed second amended individual income tax returns for the d5 taxable year and treated Trust 3 and Trust 4 in a manner consistent with the QSST elections. As part of the second amended returns, C paid an income tax in the amount of m and D paid an income tax in the amount of n.

X represents that its ineffective S corporation election was inadvertent, unintended, and not the result of tax avoidance or retroactive tax planning. X further represents that at all times subsequent to d2, X has treated Trust 1, Trust 2, Trust 3, and Trust 4 as QSSTs. In addition, X represents that, except for the filing of the amended returns on d4, the beneficiaries of Trust 1, Trust 2, Trust 3, and Trust 4 have treated the trusts as QSSTs. X and all its shareholders who were shareholders since d2 agree to make any necessary adjustments consistent with the treatment of X as an S corporation as the Secretary may require.

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, in part, that the term “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 the purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I subchapter J of chapter 1 of the Internal Revenue Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder in an S corporation.

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), (A) the trust is treated as a trust described in § 1361(c)(2)(A)(i), and (B) for purposes of § 678(a), the beneficiary of the trust is 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)(2) apply.

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 a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(j)(6)(i) provides that any action required by § 1.1361-1(j) to be

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taken by a person who is under a legal disability by reason of age may be taken by that person's guardian or other legal representative, or if there be none, by that person's natural or adoptive parent.

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(a)(2) provides that an election under § 1362(a) shall be valid only if all persons who are shareholders in such corporation on the day on which the election is made consent to the election.

Section 1.1362-6(b)(1) provides that except as provided in § 1.1362-6(b)(3)(iii), the election of the corporation is not valid if any required consent is not filed in accordance with the rules contained in § 1.1362-6(b).

Section 1.1362-6(b)(2)(iv) provides that in the case of a trust described in § 1361(c)(2)(A) (including a trust treated under § 1361(d)(1)(A) as a trust described in § 1361(c)(2)(A)(i)), only the person treated as the shareholder for purposes of § 1361(b)(1) must consent to the election.

Section 1.1362-6(b)(2)(ii) provides that the consent of a minor must be made by the minor or by the legal representative of the minor (or by a natural or an adoptive parent of the minor if no legal representative has been appointed).

Section 1362(f) provides that (1) if 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 § 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 such ineffectiveness or termination, steps were taken so that the corporation is a small business corporation or to acquire the required shareholder consents, and (4) the corporation, 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 ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election was ineffective for the taxable year beginning d2. We also conclude that the ineffectiveness of X's S corporation election was an inadvertent invalid election within the meaning of § 1362(f).

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We further conclude that under § 1362(f), X will be treated as an S corporation from d2 and thereafter, provided that, apart from the amended returns described above, X's S corporation election is otherwise valid and is not otherwise terminated under § 1362(d). In addition, Trust 1, Trust 2, Trust 3, and Trust 4 will be treated as trusts described in § 1361(c)(2)(A)(i) and A, B, C, and D will be treated, for purposes of § 678, as the owners of the portion of Trust 1, Trust 2, Trust 3, and Trust 4, respectively, that consists of X stock from d2, and thereafter, provided that the trusts satisfy the QSST requirements. Accordingly, the shareholders of X must include their pro rata share of the separately and nonseparately 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 to shareholders as provided in § 1368.

This ruling is conditioned on X, within 60 days of the date of this letter, filing a new Form 2553, Election of a Small Business Corporation, that contains the proper signatures, with the appropriate service center with an effective date of d2. Furthermore, A, B, C, and D must make a QSST election, that contains the proper signature, for Trust 1, Trust 2, Trust 3,] and Trust 4, respectively, effective d2, with the appropriate service center within 60 days of the date of this letter. A copy of this letter should be attached to the new form 2553 and the new QSST elections.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed on whether X is otherwise eligible to be an S corporation or whether Trust 1, Trust 2, Trust 3, and Trust 4 are valid QSSTs.

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, we are sending a copy of this letter to X.

Sincerely yours,

Mary Beth Collins
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

A copy of this letter

A copy for §6110 purposes

cc: