

Internal Revenue Service

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Date:

March 2, 2005

X =

A =

Trusts =

D1 =

D2 =

Year 1 =

Dear :

PLR-158099-04

This letter responds to a letter dated November 1, 2004, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS:

The information submitted states that X elected to be an S corporation effective D1. On D1, the Trusts were shareholders of X. It is represented that each of the Trusts satisfy the requirements of a Qualified Subchapter S Trust (QSST) under § 1361(d)(2) and that they each timely filed QSST elections. Under each of the Trust's governing instruments, the trustees are not required to distribute annually all of the trust's income (within the meaning of § 643(b)) to each trust's current income beneficiary. For Year 1, the trustees of the Trusts failed to distribute all of the Trusts' income as required by § 1361(d)(3)(B).

A represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. 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. The Trusts have since distributed all of the income as required by § 1361(d)(3)(B) for Year 1 to each of the Trusts' respective beneficiary.

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 an S 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 1361(d)(1) provides 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).

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one 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 beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is

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distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1361(d)(4)(B) provides that if any QSST ceases to meet any requirement of § 1361(d)(3)(B) but continues to meet the requirements of § 1361(d)(3)(A), the provisions of § 1361(d) shall not apply to the trust as of the first day of the first taxable year beginning after the first taxable year for which the trust failed to meet the requirements of § 1361(d)(3)(B).

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 first taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation.

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

CONCLUSIONS:

Based on the facts submitted and the representations made, we conclude that X's S corporation election terminated on D2, because the trustees of the Trusts failed to distribute all of the Trusts' income for Year 1. We also conclude that the termination was inadvertent under § 1362(f). Therefore, under § 1362(f), X will be treated as continuing to be an S corporation from D2, and thereafter, provided that X's S corporation election is valid and is not otherwise terminated under § 1362(d). If X, and its shareholders, including the Trusts, fail to treat X as described above, this ruling will be null and void. Moreover, this ruling is contingent on X and all of its shareholders treating X as having been an S corporation from D2, and thereafter, and on X and its shareholders making any adjustments necessary for the consistent treatment of X as an S corporation.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding whether X is

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otherwise qualified to be an S corporation, or whether the Trusts are otherwise valid QSSTs.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's first and second authorized representatives.

Sincerely,

Beverly Katz
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
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