

Internal Revenue Service

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Person To Contact:
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Telephone Number:

Refer Reply To:
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Date: July 16, 2009

Legend

X =

A =

B =

Trust 1 =

Trust 2 =

Trust 3 =

State =

m =

n =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This responds to a letter dated January 29, 2009, and subsequent correspondence, submitted on behalf of X from X's authorized representative, requesting inadvertent termination relief pursuant to § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on Date 1 and it made an election to be treated as an S corporation on Date 2. On Date 3, A and B transferred m shares of X to Trust 1. Pursuant to the terms of Trust 1, n shares of X were held in a separate trust, Trust 2, for the benefit of B. Trust 2 was treated as owned by B and was described in § 1361(c)(2)(A)(i).

On Date 4, B died. The n shares of X were then to be held by Trust 3. Under the terms of Trust 3, the sole beneficiary of Trust 3 was A. X represents that Trust 3 was intended to qualify as a qualified subchapter S trust (QSST) under § 1361(d). However, A did not file a timely QSST election on behalf of Trust 3. Therefore, X's S corporation election terminated on Date 4. On Date 5, A died.

X 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 represents that A reported A's allocable share of X's income consistent with the treatment of X as an S corporation on all affected returns. 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.

Law and Analysis

Section 1362(a) 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 1361(a) 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) provides, in part, 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, 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 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(c)(2)(B)(i) provides that, for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

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) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, (B) 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 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(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be 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) or (3), (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 for which the termination occurred

is a small business corporation, 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 termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the representations made and the information submitted, we conclude that X's S corporation election terminated under § 1362(d)(2) on Date 4, when Trust 3 became an ineligible shareholder. We also conclude that this termination was inadvertent within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 4 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d).

All of X's shareholders in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and non-separately stated computed items of income or loss of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368.

Additionally, during the termination period and thereafter, Trust 3 will be treated as a QSST described in § 1361(d)(3) (assuming the trust otherwise qualifies as a QSST), and A, and then A's estate, will be treated as the owner of the X stock held by Trust 3, provided that A's estate files a QSST election effective Date 4 with the appropriate service center within 60 days following the date of this letter. If Trust 3, X, or X's shareholders fail to treat X as described above, this ruling shall be null and void. A copy of this letter should be attached to the QSST election.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed regarding whether X is otherwise eligible to be treated as an S corporation or whether Trust 3 is otherwise eligible to be a QSST under § 1361(d)(3).

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

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

David R. Haglund

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

Enclosures (2)

Copy of this letter

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