

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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LEGEND

Company =

Date1 =

Date2 =

Date3 =

Date4 =

State =

Trust =

A =

Dear :

This letter responds to a letter dated June 23, 2009, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

Company is a State corporation that elected to be an S corporation effective Date1. On Date2, stock in Company was transferred to Trust. Prior to the transfer, Trust was an eligible S corporation shareholder because it was a trust under § 1361(c)(2)(A)(i). After the transfer, Trust ceased to be a trust under § 1361(c)(2)(A)(i) and consequently, Company's S corporation election terminated on Date2.

On Date3, Company learned that its S corporation election had terminated on Date2. Since Date2, Company has treated Trust as a qualified subchapter S trust (QSST) under § 1361(d) and A, the income beneficiary of Trust, has reported A's allocable share of Company's income consistent with the treatment of Trust as a QSST. Trust, however, did not qualify as a QSST under § 1361(d) because A failed to file a QSST election and Trust could distribute income and corpus to A's dependents. A does not have any dependents and distributions from Trust have only been made to A. On Date4, a State court approved a modification to Trust so that now during A's life Trust may only distribute income and corpus to A.

Company represents that there was no intent to terminate Company's S corporation election and that the termination was inadvertent and not motivated by tax avoidance or retroactive tax planning. Company and its shareholders have treated Company as an S corporation since Date1. In addition, Company and its shareholders agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary.

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) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

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 of the Internal Revenue Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1)(A) 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) 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 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 statement including the information listed in § 1.1361-1(j)(6)(ii).

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

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 the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in part, 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 for which the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 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 with respect to such period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that Company's S corporation election terminated on Date2 when stock in Company was transferred to Trust, an ineligible S corporation shareholder. We also conclude that this termination of Company's S corporation election was inadvertent within the meaning of § 1362(f).

Accordingly, under § 1362(f), Company will be treated as continuing to be an S corporation from Date2 and thereafter, provided that Company's S corporation election was valid and was not otherwise terminated under § 1362(d), and provided that A files a

QSST election for Trust with an effective date of Date2 with the appropriate service center within 60 days from the date of this letter. A copy of this letter should be attached to the QSST election.

During the termination period and thereafter, Trust will be treated as a QSST described in § 1361(d)(3) (assuming the trust otherwise qualifies as a QSST), and A will be treated as the owner of Company stock held by Trust. Accordingly, all of Company'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 computed items of income or loss of Company under § 1366, make any adjustments to basis under § 1367, and take into account any distributions made by Company under § 1368. If Trust, Company, or Company's shareholders fail to treat Company as described above, this ruling shall be null and void.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express no opinion on whether Company is otherwise eligible to be an S corporation or whether Trust qualifies as a QSST.

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, we are sending a copy of this letter to Company's authorized representative.

Sincerely,

/s/

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for Section 6110 purposes

cc: