

2. As of Date 3, Parent distributed its stock in Company to Parent's shareholders Trust 1, Trust 2, and Trust 3. Company intended to elect to be an S corporation effective Date 3 but the proper election was not filed.

Trust1, Trust 2, and Trust 3 were also ineligible S corporation shareholders. Company represents that Trust 1, Trust 2, and Trust 3 met the qualified subchapter S trust (QSST) trust requirements described in § 1361(d)(3) as of Date 3 and thereafter except that Trust1, Trust 2, and Trust3 failed to distribute all of their income to their beneficiaries for Year. Further, none of the income beneficiaries timely filed QSST elections.

On Date 4, Company filed a certificate of dissolution with State.

Company and its shareholders represent that they intended Company be an S corporation immediately after the termination of the QSub election. Company represents that Company and its shareholders have filed their federal income tax returns consistent with having a valid S corporation election in effect for Company. Company and its shareholders have agreed to make such 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) provides that the term “small business corporation” means 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)(3), 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(b)(3)(A) provides that, except as provided in regulations prescribed by the Secretary, for purposes of the Code — (i) a corporation which is a QSub shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that, for purposes of § 1361(b)(3), the term “qualified subchapter S subsidiary” means any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)), if — (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a QSub.

Section 1361(b)(3)(D) provides, in part, that if a corporation's status as a QSub terminates, such corporation (and any successor corporation) shall not be eligible to make an election under § 1362(a) to be treated as an S corporation before its 5th taxable year which begins after the 1st taxable year for which such termination was effective, unless the Secretary consents to such election.

Section 1.1361-5(a)(1)(iii) of the Income Tax Regulations provides that a QSub election will terminate at the close of the day on which an event occurs that renders the subsidiary ineligible for QSub status under § 1361(b)(3)(B).

Section 1.1361-5(c)(2) provides that in the case of S and QSub elections effective after December 31, 1996, if a corporation's QSub election terminates, the corporation may, without requesting the Commissioner's consent, make an S election before the expiration of the five-year period described in § 1361(b)(3)(D) if immediately following the termination, the corporation (or its successor corporation) is otherwise eligible to make an S election and the relevant election is made effective immediately following the termination of the QSub election.

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(b)(1) provides that an election under § 1362(a) may be made by a small business corporation for any taxable year - (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before the 15th day of the third month of the taxable year.

Section 1362(b)(5) provides that if (A) an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)), after the date prescribed by § 1362(b) for making such election for such taxable year or no such election is made for any taxable year, and (B) the Secretary determines that there was reasonable cause for the failure to timely make the election, the Secretary may treat such an election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1362(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1362(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

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 (with the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(f) provides, in part, that if (1) 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), (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, steps were taken so that the corporation for which the election was made is a small business corporation, and (4) the corporation for which the election was made, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make 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, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based on the facts submitted and representations made, Company has established reasonable cause for failing to make a timely S corporation election. Thus, we conclude that Company is eligible for relief under § 1362(b)(5). Accordingly, if Company makes an election to be an S corporation by filing with the appropriate service center a completed Form 2553 effective Date 3, within 120 days following the date of this letter, the election shall be treated as timely made. A copy of this letter should be attached to the Form 2553 filed with the service center. A copy is enclosed for that purpose.

Company failed to timely file an election to be treated as an S corporation effective Date 3. Had Company timely filed the election it would have been ineffective because Company had ineligible shareholders on Date 3. Based solely on the facts submitted and representations made, we conclude that Company's election to be treated as an S corporation effective Date 3, would have been ineffective and also conclude that the ineffectiveness would have been in advertent within the meaning of § 1362(f).

Under the provisions of § 1362(f), Company will be treated as an S corporation and Trust 1, Trust 2, Trust3 will be treated as QSSTs effective Date 3 and thereafter. This conclusion is reached provided that Company's S corporation election is otherwise valid and was not otherwise terminated and Trust1, Trust2 and Trust3's QSST elections are otherwise valid and not terminated.

This ruling is conditioned on the income beneficiaries of Trust1, Trust2, and Trust3 filing QSST elections effective Date 3 with the appropriate service center. The QSST elections must be filed within 120 days following the date of this letter and a copy of this letter should be attached to any such elections or returns. If Company, Trust1, Trust2, Trust3, and their beneficiaries fail to treat themselves as described above, this ruling is null and void.

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, we express or imply no opinion regarding whether Company is otherwise eligible to be an S corporation or whether Company was a valid QSub.

This ruling 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. The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to Company's authorized representatives.

Sincerely,

Faith P. Colson

Faith P. Colson
Senior Counsel, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)
Copy of Letter
Copy for 6110 purposes