

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

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X =

A =

B =

C =

D =

Trust 1 =

Trust 2 =

D1 =

D2 =

D3 =

D4 =

D5 =

Dear :

This letter responds to a letter, dated July 24, 2000, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1. X elected to be an S corporation beginning on D2. On D3, B, a shareholder of X at the time, transferred all B's X stock to Trust 1. A represents that Trust 1 was an eligible S corporation shareholder under § 1361(c)(2)(A)(i).

B died on D4. Upon B's death the X stock in Trust 1 was transferred to Trust 2. C was the sole beneficiary of Trust 2 during C's lifetime. C died on D5, at which time the X stock was distributed equally to A and D. A represents that Trust 2 is qualified under § 1361(d) to be a Qualified Subchapter S Trust (QSST). However, C inadvertently failed to file an election under § 1361(d)(2) to qualify Trust 2 as a QSST.

A further represents that neither X nor any of its shareholders engaged in tax avoidance or retroactive tax planning and that X intended to maintain its status as an S corporation at

all times.

X, and X's shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require for the period of termination.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under section 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a "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 section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual.

Section 1361(d)(1) provides that in the case of a qualified subchapter S trust (QSST) with respect to which a beneficiary makes an election under § 1361(d)(2), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, 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) of the Code 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. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under section 1362(a) by any corporation was terminated under section 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 the 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 under section 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 for that 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.

Based solely on the facts and representations submitted, we hold that X's S corporation election terminated on D4 when Trust 2, an ineligible S corporation shareholder, acquired X stock. We also conclude that the termination was inadvertent within the meaning of § 1362(f).

We further hold that under the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D4 to D5, provided X's S election was not otherwise terminated and provided Trust 2 satisfied the requirements to be a QSST and C is treated under § 678 as the owner of the portion of Trust 2 consisting of X stock during the period from D4 to D5.

Accordingly, the shareholders of X must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, during the period from D4 to D5, this ruling will be null and void.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was or is a small business corporation under § 1361(b) of the Code.

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.

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

Sincerely yours,
JEANNE M. SULLIVAN
Assistant to the Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
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