

Internal Revenue Service

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Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B02

PLR-130578-05

Date:

January 31, 2006

X =
EIN:

Trust =
TIN:

A =
SSN:

B =
SSN:

C =
SSN:

D =
SSN:

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Year 1 =

Dear _____ :

This letter responds to your letter dated May 26, 2005, together with subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on Date 1 and elected to be treated as an S corporation effective Date 2. On Date 4, A, B, and C owned all of the issued and outstanding shares of X. On Date 5, C transferred all of C's shares of X to Trust. Trust is an irrevocable trust that was established on Date 3 by A for the benefit of D. A, the president of X represents that Trust was intended to qualify as a Qualified Subchapter S Trust (QSST). However, no election was made to treat Trust as a QSST.

A represents that the failure to file the QSST election was not motivated by tax avoidance or retroactive tax planning and that X and X's shareholders have continued to treat X as if it were an S corporation. A also represents that after the transfer of shares to Trust, X treated D as the owner of X shares, and D reported on D's individual tax returns all items of income, loss, and deductions related to the shares of X held by D through Trust. However, in taxable Year 1, Trust erroneously issued a blank Schedule K-1, Shareholder's Share of Income, Deductions, Credits, etc., to D. X, X's shareholders and C have agreed to make any adjustments that the Secretary may require, consistent with the treatment of X as an S corporation.

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

Section 1361(b)(1)(B) provides that a "small business corporation" cannot have as a shareholder a person (other than an estate and other than 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(d)(1) provides that in the case of a QSST for which a beneficiary makes an election under § 1362(d)(2), the trust is treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of the trust shall be treated as the owner of that portion of the trust that 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 may elect to have that section apply.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the 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 § 1362(a) by any corporation (A) 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) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, 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 ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts and representations made, we conclude that X's S corporation election was terminated on Date 5, because X shares were transferred to Trust, which had not timely filed a QSST election. We also conclude that the termination of X's S corporation election was inadvertent within the meaning of § 1362(f). Accordingly, we hold that under the provisions of § 1362(f), X will be treated as an S corporation effective Date 5, and thereafter, provided that X's S election was not otherwise invalid or terminated under § 1362(d). In addition, we conclude that Trust will be granted an extension of time to file a QSST election, effective Date 5.

This ruling is contingent on X and all of its shareholders treating X as having been an S corporation for the period beginning Date 5, and thereafter. Accordingly, all of the shareholders of X, in determining their respective income tax liabilities for the period beginning Date 5, and thereafter, must include their pro rata share of the separately stated and non-separately 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 themselves as described above, this ruling shall be null and void.

This ruling is contingent on Trust making a valid QSST election, effective Date 5, with the appropriate service center within 60 days of this letter. A copy of this letter

should be attached to Trust's QSST election. Copies of the letter have been provided for this purpose. This ruling is also contingent on D amending his taxable Year 1 return to reflect the items of income, loss, deductions, credit, etc. that should have been allocated to D on the schedule K-1 for that year.

Except as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. Specifically, no opinion is expressed on whether Trust is eligible to elect to be treated as a QSST or on whether X is otherwise eligible to be treated as an S corporation.

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.

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

Sincerely yours,

J. Thomas Hines
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
A copy of this letter
A copy for 6110 purposes