

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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**LEGEND**

X =

Decedent =

A =

Trust =

State =

D1 =

D2 =

D3 =

Dear :

This letter responds to a letter dated June 23, 2006, submitted by X's authorized representative on behalf of X, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

**FACTS**

The information submitted states that X was incorporated under the laws of State on D1 and elected to be an S corporation effective D1. On D2, Decedent, one of X's shareholders, died. Pursuant to Decedent's will, Decedent's shares in X were distributed as of D3 to Trust. X represents that Trust is eligible to be a Qualified Subchapter S Trust (QSST). However, due to inadvertence, A, the beneficiary of Trust,

failed to elect to treat Trust as a QSST. Because of this failure to make the QSST election, Trust was an ineligible S corporation shareholder. As a result, X's S corporation election terminated.

X represents that the transfer of stock to Trust and the subsequent failure to file the QSST election were not motivated by tax avoidance. Furthermore, X and all its shareholders represent that from D3 until the present, X, and the shareholders, have all filed returns consistent with X's status as an S corporation. X and all its shareholders have agreed to make any adjustments that the Commissioner may require consistent with the treatment of X as an S corporation.

## LAW AND ANALYSIS

Section 1361(a)(1) 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 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 subchapter S corporation shareholder.

Section 1361(d)(1) provides that a QSST with respect to which a beneficiary makes an election under § 1361(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 § 1361(d)(2) applies.

Under § 1361(d)(2)(A), a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), an election under § 1361(d)(2) will be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) provides that the term "QSST" means 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, (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 income beneficiary in the trust shall terminate on the earlier of such 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 such beneficiary; and (B) all of the income (within 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(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 1.1361-1(j)(6)(iii)(E) of the Income Tax Regulations provides that if a corporation's S election terminates because of a late QSST election, the corporation may request inadvertent termination relief under § 1362(f).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (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 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 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, the corporation shall be treated as an S corporation during the period specified by the Secretary.

## CONCLUSIONS

Based solely on the facts presented and the representations made, we conclude that X's S corporation election was terminated on D3, because A failed to make a timely QSST election under § 1361(d)(2) for Trust. We also conclude that the termination was inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as an S corporation from D3 and thereafter, assuming that X's S corporation election is valid and is not otherwise terminated under § 1362(d). However, this ruling is contingent upon A filing a QSST election for Trust, with an effective date of D3, with the appropriate service center within 60 days of the date of this ruling. A copy of this letter must be attached to the QSST election.

Except as specifically ruled above, we express no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed on whether X's original election to be an S corporation was a valid election under § 1362 or whether Trust qualifies as a QSST within the meaning of § 1361(d)(3).

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your first and second authorized representatives.

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.

Sincerely,

Beverly Katz  
Senior Technician Reviewer, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes