

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

August 10, 2001

X =

Trust 1 =

Trust 2 =

A =

B =

C =

D =

E =

F =

D1 =

D2 =

D3 =

State =

Trustee =

Dear :

This letter responds to a letter dated April 19, 2001, and earlier correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State on D1. X elected to be an S corporation effective D1. The current shareholders of X are Trust 1, Trust 2, A, B, C, D, E, and F. On D2, B transferred shares of X to Trust 1 and Trust 2. B, X's chairman/secretary, represents that Trust 1 and Trust 2 were intended to be qualified subchapter S trusts ("QSSTs"). However, X and Trustee (who was responsible for determining the required paperwork) were not aware of the requirement to file a QSST election on behalf of the trusts. No QSST election was timely filed on behalf of Trust 1 and Trust 2. Therefore, X's S election terminated on D2.

On D3, Trustee attended a Trust seminar which discussed the requirements for QSSTs. Following the seminar, Trustee discovered that no QSST election had been filed for Trust 1 and Trust 2. Additionally, Trustee discovered that the current income beneficiaries had not reported X's items of income or deduction properly.

B represents that the circumstances resulting in the termination of X's S corporation election were inadvertent. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

Section 1362(a) 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 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)(B), as in effect for taxable years beginning on or before December 31, 1997, provided 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)) 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 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)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be 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 § 1362(d)(2) or (3), (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 in 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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the representations made and the information submitted, we conclude that X's S corporation election terminated on D2, under § 1362(d)(2) of the Code, because the respective beneficiaries of Trust 1 and Trust 2 failed to timely file an election under § 1361(d)(2).

We further conclude that the termination of X's S election was an inadvertent termination within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation effective D2 and thereafter, provided X's election to be an S corporation was not invalid and provided that the election was not otherwise terminated under § 1362(d). In addition, from D2 and thereafter, Trust 1 and Trust 2 will be treated as QSSTs described in § 1361(d)(3), and the respective beneficiaries of Trust 1 and Trust 2 will be treated, for purposes of § 678, as the respective owners of the X stock held by Trust 1 and Trust 2, provided that the respective beneficiaries of Trust 1 and Trust 2 file a QSST election effective for D2 for each Trust with the appropriate service center within 60 days following the date of this letter. If Trust 1, Trust 2, X, or its shareholders fail to treat X as described above, this ruling shall be null and void. Furthermore. A copy of this letter should be attached to the QSST elections.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code, including whether Trust 1 and Trust 2 are, or ever were QSSTs under § 1361(d)(3). This ruling letter 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.

Sincerely yours,
J. THOMAS HINES
Chief, Branch 2
Office of the Associate
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
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