

## Internal Revenue Service

Number: **200747014**

Release Date: 11/23/2007

Index Number: 1362.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B1

PLR-128148-07

Date: August 2, 2007

### Legend:

X =

Y =

Z =

A =

B =

C =

M =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

#a =

Dear :

This letter responds to your letter dated June 12, 2007, on behalf of X, requesting relief under section 1362(f) of the Internal Revenue Code.

Facts:

The information submitted states that X was incorporated under the laws of State, and X filed an election under § 1362(a) to be treated as an S corporation effective as of Date 1. At the time of the election, X had three shareholders: A, B, and C. Additionally, on Date 2 X formed one wholly owned subsidiary, Y, and on Date 3 X formed another wholly owned subsidiary, Z. Although, as detailed below, X's subchapter S election had terminated at the time of the formation of the two wholly owned subsidiaries, X filed what would have been timely QSub elections for Y and Z effective Date 2 and Date 3, respectively, had X's subchapter S election still been in effect.

Beginning on Date 4, A made gifts of non-voting stock of X to an irrevocable trust known as M ("Trust"). A made #a separate gifts of non-voting stock to the Trust. A's gifts of stock made to the Trust were intended by A to inure to the direct benefit of multiple specifically named beneficiaries, each of whom is eligible to be a shareholder of an S corporation. Each specifically named beneficiary's rights under the trust instrument were set forth as rights to separate shares of the Trust.

X represents that A created substantially separate and independent shares of the Trust for each named or otherwise described beneficiary when A contributed his shares of X stock to the Trust.

X also represents that at all times after the transfers of stock to the Trust, each separate and independent share of the Trust qualified as a QSST as defined by § 1361(d), except that the beneficiaries of each separate and independent share of the Trust failed to make QSST elections under § 1361(d). As a consequence of the failure to make the QSST elections, X's S corporation election terminated on Date 4, the date of the first transfer of X stock to the Trust.

In late Year 1, X changed accounting firms, and the new accounting firm notified X that separate QSST elections were previously required to be filed by each individual beneficiary of separate shares of the Trust, in a timely manner when the stock was first transferred to the Trust, in order to maintain X's status as an S corporation. Immediately thereafter, X and its shareholders took corrective action to rectify the

situation and to restore X's status as an S corporation. This action included the preparation and submission of a request for a ruling under § 1362(f) of the Code.

It is represented that the failures to make timely elections under § 1362(d) of the Code were unintentional and inadvertent and that there was no tax avoidance motive nor retroactive tax planning motive in either failing to make the elections or in requesting termination relief. It is further represented that at all times since Date 1, X and its shareholders have treated X as an S corporation and each separate and individual share of the Trust as effective QSSTs. In addition, X and the trustees of the Trust agree to make such adjustments (consistent with the treatment of the X as an S corporation) as may be required by the Internal Revenue Service with respect to such period.

#### Law and Analysis:

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) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, 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 the 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 of an S corporation.

Section 1361(d)(3) provides that a substantially separate and independent share of a trust, within the meaning of § 663(c), shall be treated as a separate trust for purposes of § 1361(d) and § 1361(c).

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), (A) the trust is treated as a trust described in § 1361(c)(2)(A)(i), and (B) 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 (or the beneficiary's 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 two 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)(iii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever the corporation ceases to be a small business corporation.

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

Conclusion:

Based solely upon the facts submitted and the representations set forth above, we conclude that X's S election terminated on Date 4 when shares of X stock were first transferred to ineligible shareholders (the Trust). We further conclude that this transfer was inadvertent within the meaning of § 1362(f). Additionally, we conclude that each separate and independent share of the Trust is eligible to be treated as a QSST. Thus, under the provisions of § 1362(f), X will be treated as an S corporation from Date 4 and thereafter, provided that the beneficiaries of each separate and individual share of the Trust file QSST elections effective within 60 days following the date of this letter with the appropriate service center and provided that X's S corporation election is valid and not otherwise terminated under § 1362(d). Additionally, Y will be treated as a QSub from Date 2 and thereafter, and Z will be treated as a QSub from Date 3 and thereafter. A copy of this letter should be attached to the QSST elections.

X must file any amended returns and make such adjustments which are necessary to properly reflect the reporting of X's items of S corporation income. Additionally, the shareholders of X, including the beneficiaries of separate and independent shares of each QSST under the Trust, must make any necessary adjustments and amendments to their tax returns.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(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, we are forwarding a copy of this letter to your authorized representatives.

Sincerely,

David R. Haglund  
Senior Technician Reviewer, Branch 1  
Office of Associate Chief Counsel  
Passthroughs & Special Industries

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes