

Internal Revenue Service

Department of the Treasury
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Person To Contact:

Telephone Number:

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Date:

October 17, 2005

Legend

X =

Trust =

Date 1 =

Date 2 =

Dear

This letter responds to a letter dated May 25, 2005, and 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 an S corporation effective Date 1. As of Date 1, the shareholders of X consisted of individuals and eleven subtrusts of Trust. However, the beneficiaries of each of the subtrusts failed to timely make qualified subchapter S trust (QSST) elections. In addition, the trustee of Trust signed the S corporation election instead of the beneficiaries of each of the subtrusts. Accordingly, X's S corporation election was invalid. In Date 2, the tax return preparers of Trust discovered that X's S election was invalid and notified X.

The trustee of Trust represents that each of the eleven subtrusts of Trust is qualified to make a QSST election, and will make the election if X is granted relief for the inadvertent invalid election. X represents that the trustee of Trust inadvertently failed to require that the QSST elections be filed by the beneficiaries of the subtrusts. X also represents that X was unaware of the beneficiaries' failure to file the QSST elections and that these omissions took place outside the knowledge and reasonable control of X and were not a part of any plan or intention of X to terminate its S election. X represents that for all taxable years during the termination period, X and X's shareholders have filed tax returns consistent with X being 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 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 § 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 section 1361(b)(1)(B), a trust may be a shareholder if all of it 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. Section 1361(c)(2)(B)(i) provides that for purposes of section 1361(b)(1), in the case of a trust described in section 1361(c)(2)(A)(i), the deemed owner shall be treated as the 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 section 1361(d)(2), such trust shall be treated as a trust described in section 1361(c)(2)(A)(i) and, for purposes of section 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 section 1361(d)(2) is made.

Section 1362(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have section 1361(d) apply. Section 1361(d)(2)(D) provides that an election under section 1362(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 QSST election under section 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or statement including the information listed in section 1.1361-1(j)(6)(ii).

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means a trust- (A) the terms of which require that- (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust, (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 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 section 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(3) provides that for purposes of section 1361(c) and section 1361(d), a substantially separate and independent share of a trust, within the meaning of section 663(c) and the regulations thereunder, is treated as a separate trust. For a separate share which holds S corporation stock to qualify as a QSST, the terms of the trust applicable to that separate share must meet the QSST requirements stated in section 1.1361-1(j)(1)(i) and (ii).

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 1362(a)(2) provides that an election under section 1362(a) shall be valid only if all persons who are shareholders in such corporation on the day on which the election is made consent to the election.

Section 1.1362-6(b)(1) provides that except as provided in section 1.1362-6(b)(3)(iii), the election of the corporation is not valid if any required consent is not filed in accordance with the rules contained in section 1.1362-6(b).

Section 1.1362-6(b)(2)(iv) provides that in the case of a trust described in section 1361(c)(2)(A) (including a trust treated under section 1361(d)(1)(A) as a trust described in section 1361(c)(2)(A)(i)), only the person treated as the shareholder for purposes of section 1361(b)(1) must consent to the election.

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 first taxable year for which the 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 was terminated under § 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 § 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 submitted and the representations made, we conclude that X's election to be an S corporation on Date 1 was an inadvertent invalid election within the meaning of § 1362(f).

We further conclude that under § 1362(f), X will be treated as an S corporation from Date 1, and thereafter, provided that the eleven subtrusts otherwise qualify as QSSTS, and X's election to be an S corporation was otherwise valid and was not terminated under § 1362(d). Accordingly, the shareholders of X must include in income their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as 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, this letter ruling will be null and void.

This ruling is conditioned on X, within 60 days of this letter, filing a new Form 2553, Election of a Small Business Corporation, that contains the proper signatures, with the appropriate service center with an effective date of Date 1. Furthermore, the beneficiaries of each of the eleven subtrusts of Trust must file a QSST election, that contains the proper signature, effective Date 1, with the appropriate service center within 60 days of the date of this letter. A copy of this letter should be attached to the new Form 2553 and the QSST elections.

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), or whether each of the eleven subtrusts are QSSTs within the meaning of § 1361(d)(3).

This ruling 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.

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,

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

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