Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:
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Date:
 October 6, 2004

Legend

X   =

a   =

b   =

Trust 1   =

Trust 2   =

Trust 3   =

Trust 4   =

Trust 5   =

Trust 6   =

Trust 7   =

Trust 8   =

Trust 9   =

Trust 10   =

Trust 11   =

Trust 12   =

Trust 13   =

Trust 14   =

Trust 15   =

Trust 16   =

Trust 17   =

Trust 18   =

Trust 19   =

Trust 20   =

Family Trust =

State   =

d1　　　=

d2　　　=

d3　　　=

d4　　　=

d5　　　=

d6　　　=

d7　　　=

Y1　　　=

Y2　　　=

Y3　　　=

Dear

　　　This responds to a letter dated June 14, 2004, submitted on behalf of X by its authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

　　　The information submitted states that X was incorporated under the laws of State on d1 and elected to be an S corporation effective d2. Trusts 1, 2, 3, 4, 5, 6, 7, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, and the Family Trust were shareholders of X on d2. On d3, a died. The Family Trust was divided into Trust 10 and another trust that distributed its shares in X to Trusts 8 and 9 on d5.

　　　It was intended that Trusts 1, 2, 3, 4, 5, 6 and 7 qualify as Qualified Subchapter S Trusts (QSSTs). Trusts 1, 2, 3, 4, 5, 6 and 7 made QSST elections effective d2. However, for taxable years Y1 and Y2, those trusts did not distribute income annually as required by § 1361(d)(3)(B) . This caused a termination of X's S election on d4. By d6, Trusts 1, 2, 3, 4, 5, 6 and 7 made distributions for taxable years Y1, Y2 and Y3.

　　　Furthermore, Trusts 8 and 9 were intended to be QSSTs, however, b, the beneficiary of Trusts 8 and 9 did not file a QSST election on behalf of either Trust 8 or Trust 9. Although X's S election was already terminated due to the failure to distribute

income mentioned above, the transfer of X stock to Trusts 8 and 9 on d5 would also have caused a termination of X's S election. Trusts 8 and 10 sold all of their interests in X to other X shareholders effective d7 and are not current X shareholders. X represents that the remaining shareholders, Trusts 11, 12, 13, 14, 15, 16, 17, 18, 19 and 20 are all eligible shareholders with proper elections.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. 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) 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 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 with respect to which a beneficiary makes an election under § 1361(d)(2) -- (A) such trust shall be treated as a trust described in §1361(c)(2)(A)(i) and, (B) 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 1361(d)(3)(B) provides that the term QSST means a trust 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 1361(d)(4)(B) provides that if any QSST ceases to meet any requirements of § 1361(d)(3)(B), but continues to meet the requirements of § 1361(d)(3)(A), the provision of § 1361(d) shall not apply to such trust as of the first day of the first taxable year beginning after the first taxable year for which it failed to meet the requirements of § 1361(d)(3)(B).

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 d4. Additionally we conclude that X's S corporation election would have terminated on d5, because of the failure to timely file a QSST election for Trusts 8 and 9. 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 continuing to be an S corporation from d4 and thereafter, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d). All of X's shareholders in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated items of income

(including tax-exempt income), loss, deduction, or credit and non-separately stated computed items of income or loss 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.

Additionally, from d4 and thereafter, Trusts 1, 2, 3, 4, 5, 6, and 7 will be treated as QSSTs described in § 1361(d)(3) (assuming they otherwise qualify as QSSTs). From d5 through d7 for Trust 8 and from d5 and thereafter for Trust 9, both trusts will be treated as QSSTs and the beneficiary of Trusts 8 and 9 will be treated as the owner of the X stock held by Trusts 8 and 9 provided that b files a QSST election effective d5 for Trusts 8 and 9 with the appropriate service center within 60 days following the date of this letter. If Trusts 1, 2, 3, 4, 5, 6, 7, 8, 9, b, X, or X's shareholders fail to treat X as described above, this ruling shall be null and void. A copy of this letter should be attached to the QSST election.

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. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation or whether any of the trusts subject to this ruling are eligible QSSTs under § 1361(d)(3).

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

Sincerely,

Carolyn Hinchman Gray
Senior Counsel, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

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