

Internal Revenue Service

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Date:

February 17, 2010

LEGEND

Company =

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

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 =

Shareholder =

a =

b =

Dear :

This letter responds to a letter dated October 7, 2009, submitted on behalf of Company by Company's authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

Company incorporated in State 1 on Date 1, and elected to be an S corporation effective Date 2. On Date 3, Shareholder sold a shares of Company stock to Trust 1, and b shares of Company stock to Trust 2. Trust 1 and Trust 2 are governed under the

laws of State 2. Company represents Trust 1 and Trust 2 were grantor trusts wholly-owned by Shareholder during Shareholder's lifetime, thus permissible S corporation shareholders under § 1361(c)(2)(A)(i). Company represents that under State 2 law on Date 4, Trust 1's ownership of Company stock transferred to Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, and Trust 8, and Trust 2's ownership of Company stock transferred to Trust 9, Trust 10, Trust 11, Trust 12, Trust 13, and Trust 14.

Company represents that Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, Trust 9, Trust 10, Trust 11, Trust 12, Trust 13, and Trust 14 (together, the Trusts) qualify to be qualified subchapter S trusts (QSSTs) under § 1361(d), except that the beneficiary of each respective trust failed to make the election under § 1361(d)(2). Therefore, these trusts were not eligible S corporation shareholders, and Company's S corporation election terminated on Date 4.

Company represents that the circumstances resulting in the termination of Company's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Company further represents that Company and Company's shareholders have filed tax returns consistent with Company being an S corporation and with the Trusts being treated as QSSTs. Company and its shareholders agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

LAW AND ANALYSIS

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, for purposes of subchapter S, 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 § 1362(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 an S corporation 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 will 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, and (C) for purposes of applying §§ 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust shall be treated as a disposition by such beneficiary.

Section 1361(d)(2) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply.

Section 1361(d)(3) provides that for purposes of § 1361(d), 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 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 1 individual who is a citizen or resident of the United States. 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 1362(d)(2)(A) provides that an election under § 1362(a) shall 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(f) provides that if (1) an election under § 1362(a) by any corporation 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 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 so that the corporation for which the election was made or the termination occurred is a small business corporation, or to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to 1362(f), agrees to make such adjustments (consistent with the treatment of such 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.

Section 1.1362-4(b) of the Income Tax Regulations provides that for purposes of § 1.1362-4(a), the determination of whether a termination or invalid election was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination or invalid election was inadvertent. The fact that the terminating event or invalidity of the election was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination or invalidity of the election was inadvertent.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that Company's S corporation election terminated on Date 4, when stock in Company was transferred to impermissible shareholders. We further conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), Company will be treated as continuing to be an S corporation on and after Date 4, unless Company's S corporation election is otherwise terminated under § 1362(d), provided that the respective income beneficiaries for Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, Trust 9, Trust 10, Trust 11, Trust 12, Trust 13, and Trust 14 file a QSST election with the appropriate service center within 60 days following the date of this letter to be effective Date 4. A copy of this letter should be attached to each of the QSST elections.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied regarding Company's eligibility to be treated as an S corporation or the Trusts' eligibility to be QSSTs.

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

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

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for the ruling, it is subject to verification on examination.

Sincerely,

/s/

James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes

cc: