

Internal Revenue Service

Number: **200523011**

Release Date: 6/10/2005

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:B02

PLR-156680-04

Date:

February 24, 2005

X =

A =

B =

Trust 1=

Trust 2=

Date 1=

Date 2=

Date 3=

Date 4=

Date 5=

Date 6=

Dear :

This letter responds to a letter dated October 13, 2004, submitted on behalf of X by its authorized representative, requesting relief under ' 1362(f) of the Internal Revenue Code.

A, the president of X represents that X was formed on Date 1 and elected to be an S corporation effective Date 1. A and B were the original shareholders of X. A represents that B created Trust 1 on Date 2 and on Date 3 transferred all B's shares of X to Trust 1. During B's life, B had the power to revoke, modify or alter Trust 1.

B died on Date 4. Trust 1 continued to hold shares of X until Date 5, when the shares of X were transferred to Trust 2. A represents that Trust 2 was intended to qualify as a Qualified Subchapter S Trust (QSST). However, A the beneficiary of Trust 2, did not know, and the accountants and attorneys advising A did not inform A, of the need to file the QSST election required under § 1361(d)(2). On Date 6, the failure to file the QSST election was discovered and this request for relief was prepared.

A represents that the failure to file the QSST election was not motivated by tax avoidance or retroactive tax planning. A represents that A has filed A's federal income tax return consistent with the treatment of Trust 2 as a QSST. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) of the Code 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(c)(2)(A)(ii) provides that, for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after the death, is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(d)(1) provides that in the case of a QSST for which a beneficiary makes an election under ' 1361(d)(2), the trust is treated as a trust described in ' 1361(c)(2)(A)(i), and 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 may elect to have that section apply.

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 returns the applicable form or a statement including the information listed in ' 1.1361-1(j)(6)(ii).

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 the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents; 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 ineffectiveness or termination, the corporation will 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 Trust 1 was an eligible S corporation shareholder under § 1361(c)(2)(A)(i) before Date 4. After Date 4 and until Date 5, Trust 1 was an eligible S corporation shareholder under § 1361(c)(2)(A)(ii). We conclude further that X's S corporation election terminated on Date 5 when Trust 2, an ineligible S corporation shareholder, acquired X stock and that the termination was inadvertent within the meaning of § 1362(f).

We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 5 and thereafter, provided X's S corporation election was otherwise valid and provided that the election was not terminated under § 1361(d). Trust 2 will be treated as a trust described in § 1361(c)(2)(A)(i), and A will be treated as the owner of the portion of the trust that consists of X stock. The shareholders of X must include 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 themselves as described above, this ruling is null and void.

This ruling is conditioned upon A filing an appropriately completed QSST election effective Date 5, with the appropriate service center within 60 days following the date of this letter. A copy of this letter should be attached to the election.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. In particular, we express no opinion on whether Trust 2, is, or ever was, a QSST within the meaning of § 1361(d)(3).

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

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

Sincerely,

J. Thomas Hines
Branch Chief, Branch 2
(Passthroughs & Special Industries)

Enclosures: 2

Copy of this letter

Copy for § 6110 purposes