

## Internal Revenue Service

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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Date:

March 16, 2007

### LEGEND

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Trust 1 =

Trust 2 =

A =

Dear :

This responds to a letter dated November 17, 2006, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

## FACTS

According to the information submitted, X was incorporated on Date 1 under the laws of State. X elected to be treated as an S corporation effective Date 2. Trust 1, a trust that was treated (under subpart E of part I of subchapter J of chapter 1) as owned by A, was a shareholder of X. On Date 3, A died. Trust 1 continued to qualify as a permissible S corporation shareholder under § 1361(c)(2)(A)(ii) for the two-year period beginning on the day of A's death and ending on Date 4.

On Date 4, Trust 1 became an ineligible shareholder of X. As a result, X's election to be an S corporation terminated. On Date 5, Trust 1's stock in X was transferred to Trust 2. X represents that Trust 2 is an eligible shareholder that timely elected under § 1361(d)(2) to be treated as a qualified subchapter S trust (QSST), within the meaning of § 1361(d)(3), effective Date 5.

X represents that the failure to timely transfer Trust 1's stock in X to an eligible shareholder was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X further represents that X and all of its shareholders have consistently treated X as an S corporation at all times since Date 2, and that all of X's shareholders have consistently included their distributive shares of X's income on their respective federal income tax returns. Finally, X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

## 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) defines a "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

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) and § 1.1361-1(h)(1)(ii) provide that, for purposes of § 1361(b)(1)(B), a trust that is described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death is a permitted shareholder, but only for the two-year period beginning on the day of the deemed owner's death. Section 1.1361-1(h)(3)(i)(B) provides that if stock is held by a trust described in § 1.1361-1(h)(1)(ii), the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner's death.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1362(d)(2) applies.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one 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 beneficiary in the trust shall terminate on the earlier of the 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 that beneficiary; and (B) all of the income (with 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 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (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 termination, steps were taken so that the corporation is once more 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 any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the termination, the corporation will be treated as continuing to be an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the information submitted and the representations made, we conclude that X's S election terminated on Date 4 when Trust 1 became an ineligible S

corporation shareholder and that the termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation from Date 4, and thereafter, provided that X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d).

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 concerning whether X is otherwise eligible to be treated as an S corporation, or whether Trust 2 is eligible to be treated as a QSST.

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 the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

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

Enclosures (2)

Copy of this letter

Copy of this letter for § 6110 purposes