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February 3, 1999

X =

A =

B =

C =

D =

Trust 1 =

Trust 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Year 1 =

Dear

This is in reply to your letter dated August 3, 1998, and subsequent correspondence, requesting relief under § 1362(f) of

the Internal Revenue Code.

The information submitted states that X is a corporation incorporated in Year 1. On Date 1, X's accountant filed for X an election to be an S corporation effective for its taxable year beginning Date 2. At the time of the election, X's shareholders included Trust 1, a trust established by B for the benefit of B's son, A. B is also the trustee of Trust 1. C, as X's president, represents that Trust 1 is a qualified subchapter S trust (QSST) under § 1361(d)(3) of the Code.

On X's Form 2553, Election by a Small Business Corporation, with respect to Trust 1, B signed as trustee on both the S corporation election and the election under § 1361(d)(2) (QSST election). Subsequently, in the course of this request for relief regarding an untimely QSST election for another trust, it was determined that for Trust 1, B should have signed the Form 2553 and the QSST election on behalf of the beneficiary of Trust 1 in the capacity of legal representative, not as trustee.

On Date 3, B gave stock in X to Trust 2 for the benefit of D. C represents that Trust 2 was drafted to be a QSST for the specific purpose of holding X stock for the benefit of D. X's attorney, who prepared the trust agreement for Trust 2, believed that X's accountant would handle the preparation of a QSST election for Trust 2. However, because the accountant never understood that B had given X stock to a trust for the benefit of D, rather than outright to D, no QSST election was prepared. In Date 4, in the course of reviewing records for estate planning, X's attorney discovered the absence of a QSST election for Trust 2 and notified X. X immediately instructed its attorney to prepare the QSST election and to obtain relief for what X believed to be the inadvertent termination of its S election. D, as beneficiary of Trust 2, filed a QSST election dated Date 5.

C represents that there was no intent by X to knowingly make an ineffective S corporation election or fail to have a QSST election prepared with regard to Trust 2, and that the events that resulted in the ineffective S corporation election and the events that resulted in the failure to timely file a QSST election for Trust 2 were not motivated by tax avoidance or retroactive tax planning.

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) of the Code, as in effect for taxable years beginning on or before December 31, 1997, 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 and other than a trust described in § 1361(c)(2)) who is not an individual.

Section 1361(c)(2)(A)(i) of the Code 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)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(d)(1) of the Code provides that in the case of a qualified subchapter S trust (QSST) with respect to which a beneficiary makes an election under § 1361(d)(2), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, 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) of the Code provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) 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 return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(a)(1) of the Code 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) of the Code provides that an election under § 1362(a) shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1.1362-6(b)(1) of the regulations provides that

except as provided in § 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 § 1.1362-6(b).

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

Section 1362(f) of the Code 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 paragraph (2) or (3) of § 1362(d), (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 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 such ineffectiveness or 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 S corporation election was ineffective for the taxable year beginning on Date 2, as a result of B's signing the Form 2553 and the QSST election as trustee of Trust 1. We also conclude that the ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f) of the Code. In addition, the transfer of X stock to Trust 2, and the subsequent failure of the beneficiary of Trust 2 to timely file a QSST election, would have resulted in the termination of X's S corporation election had the S corporation election been effective when made and that this potential termination would have been inadvertent within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f) of the Code, X will be treated as being an S corporation from Date 2, provided that, apart from the events described above, X's S corporation election was otherwise valid and was and is not otherwise terminated under

§ 1362(d). In addition, from Date 2 and Date 3, respectively, each of Trust 1 and Trust 2 will be treated as a trust described in § 1361(c)(2)(A)(i) and the respective beneficiary will be treated, for purposes of § 678, as the owner of that portion of the trust consisting of X stock. Therefore, 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 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 shall be null and void. Finally, X should re-submit to the service center where it originally filed the Form 2553 the proper signatures for the S corporation election and the QSST election with respect to Trust 1. A copy of this letter should accompany the re-submission.

Except as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code, including whether any of the trusts is a QSST under § 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 the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely yours,

H. GRACE KIM
 Assistant to the Chief
 Branch 2
 Office of the Assistant
 Chief Counsel
 (Passthroughs and
 Special Industries)

Enclosures: 2
 Copy of this letter
 Copy for § 6110 purposes