

Internal Revenue Service

Number: **200534007**

Release Date: 8/26/2005

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-108745-05

Date:

May 12, 2005

X =

A =

B =

C =

Trust
1 =

D1 =

D2 =

D3 =

D4 =

D5 =

Dear :

This letter responds to a letter dated February 8, 2005, and subsequent correspondence, 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 an election was made for X to be an S corporation effective D1. B, a shareholder of X, died on D2. On D3 (which is within two years of D2), pursuant to the terms of B's revocable trust (which became irrevocable as of B's death), shares of X were transferred from B's estate to Trust 1. C, the beneficiary of Trust 1, represents that Trust 1 was intended to qualify as a qualified subchapter S trust (QSST) and that C has filed all returns consistent with the treatment of X as an S corporation and Trust 1 as a QSST. However, X's accountants failed to advise X or C of the need for C to file the QSST election required under § 1361(d)(2). Shortly before D4, 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 elections was 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) 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 such death may be a 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(d)(2)(A) provides that, in general, an election to be treated as an S corporation shall be terminated whenever (at any time on or after the first day of the first 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 (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)(ii) until D5, which is two years after the death of B. We conclude further that X's S corporation election terminated on D5 when Trust 1 became an ineligible S corporation shareholder 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 D5 and thereafter, provided X's S corporation election was otherwise valid and provided that the election was not terminated under § 1361(d). Trust 1 will be treated as a trust described in §§ 1361(c)(2)(A)(i) and 1361(d), and C will be treated as the owner of the portion of each 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 C filing an appropriately completed QSST election for Trust 1 effective D5, 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 1 is or 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, copies of this letter are being sent to X's authorized representatives.

Sincerely,

BEVERLY M. KATZ
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2

Copy of this letter

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