

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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March 23, 1999

LEGEND

Company =

Shareholder =

d1 =

d2 =

d3 =

d4 =

T1 =

T2 =

Dear :

This letter responds to your letter dated August 24, 1998, and subsequent correspondence written on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the facts submitted, Company was incorporated on d1, and elected to be treated as an S corporation effective d2. On d3, Shareholder, who owned 100% of Company, died. According to the terms of Shareholder's will, the stock of Company was transferred to two trusts, T1 and T2. Company and the beneficiaries of the trusts represent that both trusts satisfy the requirements under § 1361(d)(3) to be qualified

subchapter S trusts (QSSTs). However, because of a mistake by Company's attorneys and accountants, after the two year period allowed by § 1361(c)(2)(A)(iii) expired, the Trusts' beneficiaries did not timely file QSST elections as required by § 1361(d)(2), and Company's S corporation election terminated on d4.

Company recently discovered that no QSST elections had been filed and that its S election had terminated. Within a reasonable time after its discovery, Company has taken steps to correct the aforementioned mistakes. Company represents that all of its shareholders have filed their returns in a manner consistent with Company's treatment as an S corporation, and that the failure to file timely QSST elections was not for a tax avoidance purpose. Company and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of Company as an S corporation.

LAW

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that 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)(iii) provides that a trust with respect to stock transferred to it pursuant to the terms of a will may be a shareholder for the purposes of § 1361(b)(1)(B), but only for the 2-year period beginning on the day on which such stock is transferred to it.

Section 1361(c)(2)(A)(i) provides that 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 for purposes of § 1361(b)(1)(B).

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), 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 is 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 (or the beneficiary's legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) may be effective up to 15 days and two months before the date of the election.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for

which 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 terminated under § 1362(d)(2); (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 the termination, steps were taken so that the corporation is 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 under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSIONS

After applying the relevant law to the facts submitted and the representations made, we conclude that Company's S corporation election terminated on d4 as a result of the beneficiaries of T1 and T2 failing to timely file QSST elections. We also conclude that the termination was inadvertent under § 1362(f). Therefore under § 1362(f), Company will be treated as an S corporation from d3 until d4 and thereafter, provided that the beneficiaries of T1 and T2 file QSST elections for the trusts within 60 days from the date of this letter, and that Company's S corporation election is valid and is not otherwise terminated under § 1362(d). During the termination period, T1 and T2 will be treated as if they were QSSTs. Accordingly, the Shareholders of Company must include their pro rata share of the separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company to shareholders under § 1368. If Company, the trusts, or any of Company's shareholders fail to treat Company as described above, this ruling will be null and void

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding whether Company is otherwise qualified to be an S corporation, or whether the Trusts are valid QSSTs.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely Yours,

William P. O'Shea
Chief, Branch 3
Office of the Assistant Chief
Counsel
(Passthroughs and Special
Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes