

Internal Revenue Service

Department of the Treasury

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LEGEND

Company =

Area =

Business =

Estate =

a =

b =

c =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Dear

This letter responds to a letter dated May 1, 2001, and subsequent correspondence, submitted on behalf of Company requesting a ruling under § 1362(f)

of the Internal Revenue Code.

According to the information submitted, Company was incorporated under the laws of the Area on a, and engages in the business of Business. Company filed an election under § 1362(a) to be treated as an S corporation effective as of a. At the time of its incorporation, Company had one shareholder, the Estate.

On b, the Estate transferred all of its shares of Company stock in equal shares to Trust 1, Trust 2, Trust 3, and Trust 4 ("Trusts"). Company represents that at all times after the transfer the Trusts qualified as QSSTs as defined by § 1361(d), except that the beneficiaries of the Trusts failed to make QSST elections under § 1361(d)(2). The beneficiaries were not informed by the attorney supervising the transfer of Company stock to the Trusts of the need to make QSST elections. As a consequence of the failure to make the QSST elections, Company's S corporation election terminated on b, the date of the transfer of Company stock to the Trusts.

In c, the trustee of the Trusts retained the services of a law firm to help administer the Trusts. While providing those services, the law firm discovered the failure of the QSST beneficiaries to make QSST elections for the Trusts. To remedy the failure, the law firm drafted documents for the beneficiaries of the Trusts to apply for automatic relief for late QSST elections under Rev. Proc. 98-55, 1998-2 C.B. 643. However, through inadvertence the documents were never circulated for signature by the beneficiaries, but were instead misfiled in the firm's office. The law firm recently discovered that the documents necessary for automatic relief were not filed, and immediately submitted a ruling request for inadvertent termination relief on behalf of Company.

Company represents that the termination of its S corporation election was inadvertent and unintended. Company further represents that at all times subsequent to b, Company and its shareholders have treated Company as an S corporation and the Trusts as QSSTs. In addition, Company and its shareholders agree to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Service.

Section 1362(a) 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 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)(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 the 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 of an S corporation.

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), (A) the trust is treated as a trust described in § 1361(c)(2)(A)(i), and (B) 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 (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) shall be effective up to 15 days and two months before the date of the election.

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)(iii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever the 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) or (3); (2) the Secretary determines that the circumstances resulting in 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 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 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 Company's S corporation election was terminated on , when shares of Company's stock were first transferred to ineligible shareholders. We further conclude that this termination was inadvertent within the meaning of § 1362(f). Thus, under the provisions of § 1362(f), Company will be treated as an S corporation from and thereafter, provided that the beneficiaries of the Trusts file QSST elections effective within 60 days following the date of this letter with the appropriate service center and

provided that Company's S corporation election is valid and is not otherwise terminated under § 1362(d). A copy of this letter should be attached to the QSST elections.

During the termination period and thereafter, the Trusts will be treated as if they were QSSTs described in § 1361(c)(2)(A)(i), and the respective beneficiaries of the Trusts will be treated, for purposes of § 678, as the owners of that portion of the respective trusts that consists of Company stock. 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, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion 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.

Sincerely yours,

/s/

CHRISTINE ELLISON

Chief, Branch 3

Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter

Copy for § 6110 purposes