

Date 6 =
Year 1 =
Year 2 =
Year 3 =
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Year 5 =
Year 6 =
Year 7 =
Year 8 =
y =
State =

Dear :

This is in reply to your letter, dated April 27, 2004, and subsequent correspondence submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State in Year 1. Effective in Year 2, X elected to be an S corporation. On Date 1, A created Trust 1. On Date 2, A transferred y shares of X stock to Trust 1. Trust 1 was a revocable trust. At the time of the transfer of X stock to Trust 1, the shareholders of X were A, B, and C.

On Date 3, A died. Upon A's death, Trust 1 ceased to qualify as a grantor trust. Trust 1 continued to qualify as a subchapter S trust under § 1361(c)(2)(A)(ii) for the 2-year period beginning on the day of the deemed owner's death and ending on Date 4. Trust 1 did not distribute the shares of X stock on or before Date 4. Accordingly, Trust 1 ceased to qualify as an eligible shareholder on Date 5.

Pursuant to the terms of Trust 1 the assets of Trust 1 were to be held in a marital trust, Trust 2, and a non-marital trust, Trust 3. On Date 6, the y shares of X were transferred to Trust 3. Trust 3 was intended to qualify as a qualified subchapter S trust

(QSST) under § 1361(d). However, due to an oversight, D, the beneficiary of Trust 3, failed to file the QSST elections required under § 1361(d)(2).

X represents that all of its shareholders have filed their returns in a manner consistent with X's treatment as an S corporation. X also represents that the terminating event, Trust 1 ceasing to be an eligible shareholder, was not motivated by tax avoidance or retroactive tax planning. For the taxable Year 3, Year 4, and part of Year 5, Trust 1 was treated as the owner of the X stock and filed its returns accordingly. Since Date 6, Trust 3 has been treated as the owner of the X stock and filed its returns accordingly.

X and X's shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that the Secretary may require.

Section 1361(a)(1) of the Code provides that an S corporation means 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 the term small business corporation is 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) 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 I) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1362(c)(2)(A)(ii) provides that a trust which was described in clause (i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2 year period beginning on the day of the deemed owner's death may be a shareholder.

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), 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)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1362(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 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)(ii).

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 taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

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 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 who was a shareholder in 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 election was terminated on Date 5, the day after the two year period that began on Date 3, because Trust 1 was no longer an eligible shareholder of X. We conclude that this termination was inadvertent within the meaning of § 1362(f). Furthermore, if the S corporation election had not been otherwise terminated on Date 5, X's S election would have terminated on Date 6 when Trust 3, an ineligible shareholder, first acquired X stock. This potential termination would have also been an inadvertent termination under § 1362(f). Accordingly, under the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 5, and thereafter, provided that X's S election was valid and was not otherwise terminated under § 1362(d).

This ruling is contingent on X and all of its shareholders treating X as having been an S corporation for the period beginning Date 5 and thereafter. Accordingly, all of the shareholders in X, in determining their respective income tax liabilities for the period beginning Date 5 and thereafter must include their pro rata share of the separately stated and non-separately 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.

Furthermore, this ruling is contingent on Trust 3 making a QSST election, effective Date 6, with the appropriate service center within 60 days of the date of this letter and attaching a copy of this letter to the election. This ruling is also contingent on Trust 3 and D amending their respective tax returns for taxable Year 6, Year 7, and Year 8 in order to conform with the proper treatment of Trust 3 as a QSST.

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. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation or whether Trust 3 is eligible to be a QSST.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) 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 the taxpayer.

Sincerely,

J. Thomas Hines
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

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