

Internal Revenue Service

Department of the Treasury

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Date:

April 27, 2001

X =

A =

D1 =

D2 =

Trust 1 =

Trust 2 =

Trust 3 =

Dear :

This letter responds to a letter dated December 13, 2000, and subsequent correspondence, submitted by you as X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1. A, the president of X, represents that X was intended to be an S corporation for federal income tax purposes effective D1. A further represents that a Form 2553, Election by a Small Business Corporation, was timely filed for X.

The shareholders of X, as of D1 and at all times thereafter, are Trust 1, Trust 2, and Trust 3 (collectively, the Trusts). A represents that the Trusts qualify as qualified subchapter S trusts (QSSTs), except that the beneficiaries of the Trusts failed to make QSST elections under § 1361(d)(2).

A further represents that X relied on its legal advisers to prepare the necessary documents in order to effectuate X's S

corporation election, including those related to the Trusts. X's legal advisers failed to ensure that the Trusts would be eligible S corporation shareholders. The failure of the Trusts to so qualify was not discovered until D2, in the course of an audit of X, now complete.

A represents that the ineffectiveness of X's election to be taxed as an S corporation was inadvertent and was not motivated by tax avoidance intent.

X and its shareholders consent to adjustments consistent with the treatment of X as an S corporation. A represents that X and its shareholders have treated X as an S corporation and the Trusts as QSSTs, and have reported X's income consistent with this treatment.

Section 1362(a) 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 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, in part, 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(d)(1) provides that in the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under § 1361(d)(2), (A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i), and (B) for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust consisting of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

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 1361(d)(2)(A) provides that a beneficiary of a qualified subchapter S trust (or a 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 2 months before the date of the election.

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 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. We further conclude that the ineffectiveness of the election was "inadvertent" within the meaning of § 1362(f).

We further hold that under the provisions of § 1362(f) of the Code, X will be treated as an S corporation from D1 to the date that is 60 days after the date of this letter provided that X is otherwise qualified to be an S corporation. During this period, the Trusts will be treated as trusts 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 trust that consists of X stock. The shareholders of X must, in determining their federal income tax liabilities, report their pro rata share of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X as provided in

§ 1368. This ruling is further conditioned on the beneficiaries of the Trusts making elections described in § 1361(d)(2) that are effective within 60 days following the date of this letter. A copy of this letter should be attached to the elections. If X or its shareholders fail to treat X as described above, this ruling will be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. In particular, we express no opinion concerning whether X otherwise qualifies to be an S corporation or whether Trusts are otherwise qualified to be QSSTs.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that 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 forwarded to X.

Sincerely yours,
JEANNE M. SULLIVAN
Acting Senior Technician
Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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