

Internal Revenue Service

Department of the Treasury

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X =

A =

Trust 1 =

Trust 2 =

Date 1 =

Year 1 =

Year 2 =

M =

Dear

This is in reply to a letter dated August 14, 2001, submitted on behalf of X, requesting relief under §1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X is a corporation which elected to be treated as an S corporation in Year 1. In Year 2, one of the shareholders of X, A, created Trust 1 and Trust 2 for the benefit of his respective adult sons. On Date 1, A made gifts of M shares of common stock of X to each of the trusts. A specifically used language in each trust that would qualify it as a “qualified subchapter S trust” (“QSST”) under §1361(d). However, due to an oversight, the beneficiaries of the trusts failed to file the elections required under §1361(d)(2).

Since Date 1, X has continued to operate and file its state and federal income tax returns as though it were an S corporation. X and its shareholders have agreed to make any adjustments that are deemed necessary to be consistent with the treatment of X as an S corporation since Date 1. X represents that there was no intent to terminate X's S election, and that the failure to file timely QSST elections was not motivated by tax avoidance or retroactive tax planning.

Law and Analysis

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

Section 1361(b)(1)(B), as in effect on Date 1, provided 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 and other than a trust described in §1361(c)(2)) 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)(B)(i) provides that for purposes of §1361(b)(1), in the case of a trust described in §1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under section §1362(d)(2) will be treated as a trust described in §1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of §678(a)) of that portion of the QSST's S Corporation stock to which the election under §1361(d)(2) applies. Under §1361(d)(2)(A), a beneficiary of a QSST may elect to have §1361(d) apply. Under §1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of §643(b) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

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 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.

Conclusion

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election was terminated on Date 1 as a result of the transfer of X stock to Trust 1 and to Trust 2, and the subsequent failure of the beneficiaries of Trust 1 and Trust 2 to timely file QSST elections. In addition, we conclude that this termination was inadvertent within the meaning of §1362(f). Pursuant to the provisions of §1362(f), X will be treated as continuing to be an S Corporation on Date 1 and thereafter provided that the election was otherwise valid and is 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 on Date 1, and thereafter. Accordingly, the shareholders of X 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. Furthermore, this ruling is contingent on the income beneficiaries of Trust 1 and Trust 2 filing QSST elections with the appropriate service center, effective Date 1, within 60 days from the date of this letter. A copy of this letter should be attached to the QSST elections. Provided these elections are made, Trust 1 and Trust 2 will be treated as trusts described in §1361(c)(2)(A)(i), and the respective beneficiaries will be treated, for purposes of §678, as the owner of that portion of each trust consisting of X stock. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

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, including whether Trust 1 and Trust 2 are eligible to be QSSTs under §1361(d)(3).

This ruling is directed only to the taxpayer who requested it. Section §6110(k)(3) of the Code 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 X's authorized representative.

Sincerely,
Matthew Lay
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of Letter

Copy for §6110 purposes