

Internal Revenue Service

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Person To Contact:
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Telephone Number:

Refer Reply To:
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Date:
Nov 18 2004

Legend:

X =

State =

D1 =

D2 =

A =

D3 =

Trust =

Dear _____ :

This responds to the letter dated July 30, 2004, and related correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code (“Code”) for an inadvertent termination of S election.

FACTS

The information submitted discloses that X is a corporation organized under the laws of State, and elected to be treated as a Subchapter S corporation effective D1. On D2, one of the original shareholders of X, A, died. On D3, a portion of X's stock was

transferred to Trust, which was created under the terms of A's will. As a result, A's estate no longer held X stock. The shareholders of X intended Trust to be treated as a qualified subchapter S trust (QSST) and, therefore, an eligible shareholder of X. The election, however, was not filed.

LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation," with respect to any taxable year, as a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a small business corporation cannot 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 for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will may be a shareholder of an S corporation, but only for the two year period beginning on the day on which such stock is transferred to it.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), thereby, an eligible shareholder of an S corporation, 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 § 1362(d)(2) applies.

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 the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of cessation. § 1362(d)(2)(B).

Section 1362(f), in relevant part, 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 the 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 once more a small business corporation; and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, 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.

CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that X's S election terminated on D3, upon the transfer of X stock to Trust. We also conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f).

Further, we conclude that, pursuant to § 1362(f), X will be treated as continuing to be an S corporation from D3 and thereafter, provided that, X's S election was otherwise valid and has not otherwise terminated under § 1362(d).

In addition, this ruling is contingent upon the beneficiary of Trust filing a QSST election with the appropriate service center within sixty (60) days from the date of this letter, effective D3. A copy of this letter should be attached to the election.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X is a valid S corporation or whether Trust is a valid 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/s/ David R. Haglund

David R. Haglund
Senior Technician Reviewer
Branch 1
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Enclosures (2)
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