Internal Revenue Service

Department of the Treasury

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LEGEND

Company =

d1 =

d2 =

d3 =

d4 =

d5 =

d6 =

Shareholder =

Trust =

:

Beneficiary =

Dear

This letter responds to a letter by your authorized representative dated February 25, 1999, and subsequent correspondence, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, Company was incorporated on d1, and elected to be treated as an S corporation effective d2. On d3, and again on d4, Shareholder transferred shares of Company to Trust, which was established for the sole benefit of Beneficiary. Trust was established to meet the requirements of a Qualified Subchapter S Trust (QSST) as defined by § 1361(d)(3). However, due to an oversight by Beneficiary's tax advisers, Beneficiary failed to file the QSST election. Thus, Trust was an ineligible shareholder of Company, and Company's S corporation election terminated on d3. During the period of termination, Shareholder and Beneficiary, the only shareholders of Company, filed tax returns consistent with Company being an S corporation, and Trust being a QSST.

In d5, the Company retained new accountants, who while reviewing Company's records, discovered that QSST election was never filed, and that Company's S corporation election had terminated. On d6, Beneficiary filed a QSST election. Company maintains that the failure to file the election was neither intentional, nor motivated by tax avoidance or retroactive tax planning. Company and its shareholders agree to make any adjustments that the Commissioner may require consistent with treating Company as an S corporation.

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 for the taxable year.

Section 1361(b)(1)(B) provides that a “small business corporation” means a domestic corporation that is not an ineligible corporation and that 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 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, is an eligible 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 shall be 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 the portion of the trust consisting 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 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(d)(2)(A) provides than an election to be an S corporation shall be terminated whenever (at any time on or after the first day of the first taxable year for which corporation is an S corporation) such 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); (2) the Secretary determines that the circumstances resulting in such 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 the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSIONS

After applying the relevant law to the facts submitted and representations made, we conclude that Company's S corporation election terminated on d3, when Shareholder transferred shares of Company to an ineligible shareholder. Furthermore, we rule that this termination was inadvertent within the meaning of § 1362(f). Under § 1362(f), Company will be treated as being an S corporation from d3 until d6 and thereafter, provided Company's S corporation election was valid and was not otherwise terminated under § 1362(d). During the termination period, the Trust will be treated as if the QSST election were timely made. Accordingly, Beneficiary, and Shareholder, in determining their respective income tax liabilities during the termination period and thereafter, must include the pro rata share of the separately and nonseparately computed items of Company as provided in § 1367, and take into account any distributions made by Company as provided by § 1368. If Company, Trust , or any of Company's shareholders fail to treat Company as described above, this ruling shall be null and void.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express no opinion whether Company is otherwise qualified to be an S corporation, or whether Trust is a valid QSST.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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,

William P. O'Shea
Chief, Branch 3
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)