

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B01-PLR-132345-03
Date:
July 25 2003

Legend:

X =

Decedent =

Y =

QSST Trust =

Trust A =

Trust B =

Trust C =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

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State =

Dear :

This letter is in response to your request for a ruling, dated February 21, 2003, on behalf of X, seeking inadvertent termination relief under section 1362(f) of the Internal Revenue Code.

Facts

Based upon the materials submitted and representations within, X was incorporated under the laws of State on Date 1. X also elected to be treated as a S corporation effective Date 1.

On Date 2, Decedent and Y transferred their interests in X to Trust A. Decedent died on Date 3. Upon Decedent's death, both Trust C and the QSST Trust were created. QSST Trust was created as a subtrust of Trust B. Trust A continued to hold the X stock and other assets on Date 4, which is the day after the two-year period expires.

On or about Date 5, the attorney for the estate discovered that X's S corporation status had terminated on Date 4 because Trust A continued to hold the stock of X, and the Qualified Subchapter S Trust (QSST) elections had not been timely filed for Trust C and QSST Trust.

At all times since Decedent's death, the parties intended that the shares of X stock be held in a trust that was a permitted S corporation shareholder. X represents that failing to file the QSST elections was not part of a plan to terminate X's S election nor was it motivated by tax avoidance or retroactive tax planning. X represents that it has at all times operated as an S corporation and was treated as such by its shareholders on their tax returns. X and its shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation) that may be required by the Commissioner.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under 1362(a) is in effect for the year.

Section 1361(b)(1)(B) provides 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.

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Section 1361(c)(2)(A)(ii) provides that for purposes of 1361(b)(1)(B), a trust which was described in 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

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 the beneficiary of a QSST (or his 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 1361(d)(3) provides that a QSST means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only 1 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 income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1362(a) 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 1362(d)(2)(A) provides that an election under 1362(a) terminates whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides that (1) an election under 1362(a) by an corporation (A) was not effective for the taxable year for which made (determined without regard to 1362(b)(2)) by reason of 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 the 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

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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 on the materials submitted and representations made within, we conclude that X's S corporation election was terminated on Date 4 when the two-year period described in 1361(c)(2)(A)(ii) expired. We further conclude that the termination was inadvertent within the meaning of 1362(f).

Under 1362(f), X will be treated as if it were an S corporation from Date 3 and thereafter, provided the required QSST elections with an effective date of Date 3 are filed with the appropriate service center within 60 days from the date of this letter, and X's S corporation election was otherwise valid and not otherwise terminated under 1362(d). Accordingly, X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately and nonseparately computed items of X as provided in 1367, and take into account any distributions made by X as provided in 1368. If X, or any of X's shareholders fail to treat X as described above, this ruling shall be void. A copy of this letter should be attached to the QSST election.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provisions of the Code. Specifically, we express or imply no opinion concerning whether X is otherwise qualified to be an S corporation or whether QSST Trust or Trust C are otherwise qualified to be QSSTs.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code 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 will be sent to the taxpayer.

Sincerely,

Dianna K. Miosi
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy for section 6110 purposes
Copy of this letter