

**Internal Revenue Service**

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:2

PLR-154667-04

Date:

June 17, 2005

Legend

X =  
TIN:

A =

B =  
SSN:

C =  
SSN:

D =  
SSN:

Trust 1 =

Trust 2 =  
TIN:

Trust 3 =  
TIN:

Trust 3(A) =

Trust 4 =

State =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Date 1 =

Date 2 =

Date 3 =

Dear :

This is in reply to your letter, dated September 29, 2004, and subsequent correspondence submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State in Year 1. Effective on Date 1, X elected to be an S corporation. In addition, Trust 1, a shareholder of X, elected to be treated as a qualified subchapter S trust (QSST) effective Date 1. Trust 1's sole beneficiary was A. On Date 2, A died. Trust 1 continued to qualify as a subchapter S trust under § 1361(c)(2)(A)(ii) for the 2-year period beginning on the day of the deemed owner's death.

On Date 3, Trust 2 and Trust 3, for the benefit of B and C, respectively, were funded with the stock of X held by Trust 1. Trust 2 and Trust 3 were ineligible shareholders, and therefore, X's S election was terminated on Date 3. In Year 4, B died and Trust 2's assets were appointed but not transferred to Trust 4, a trust that X represents is qualified to elect to be treated as a QSST, for the benefit of D. X represents that the following remedial actions will be taken. Trust 2 will transfer its X stock to Trust 4. Also, Trust 3 will transfer its X stock to Trust 3(A), a trust which X represents is qualified to elect to be treated as a QSST.

X represents that the terminating event, the transfer of X stock to Trust 2 and Trust 3, was not motivated by tax avoidance or retroactive tax planning. For all taxable years beginning in Year 2 and thereafter, Trust 2 and Trust 3 have reported the items of income, gain, deduction, and loss attributable to X on their federal income tax returns. During this period, all of Trust 3's fiduciary income was distributed to C and reported on C's federal income tax returns in accordance with K-1s issued by Trust 3. For all

taxable years beginning in Year 2 and ending in Year 3 (the taxable year of B's death), all of Trust 2's fiduciary income was distributed to B and was reported on B's federal income tax returns in accordance with K-1s issued by Trust 2. In all taxable years since B's death, all of Trust 2's fiduciary income was distributed to D, B's widow and the sole lifetime beneficiary of Trust 4, and was reported on D's federal Income tax returns in accordance with K-1s issued by Trust 2. X and X's shareholders agree to make any adjustments consistent with the treatment of X as an S corporation that the Secretary may require.

Section 1361(a)(1) of the Internal Revenue Code defines an "S corporation" 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 and other than a trust described in § 1361(c)(2) or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2) 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 a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under §1362(d)(2) is effective on and after the date of cessation.

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 election was terminated on Date 3 when Trust 2 and Trust 3, ineligible shareholders, acquired X stock. We also conclude that this termination was inadvertent within the meaning of § 1362(f). Accordingly, under the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 3, and thereafter, provided that X's S election was valid and was 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 Date 3 and thereafter. Therefore, all of the shareholders of X, in determining their respective income tax liabilities for the period beginning Date 3 and thereafter, 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. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

Furthermore, this ruling is contingent upon the X stock held by Trust 2 being transferred to Trust 4 and on Trust 4 making a QSST election, effective on the date of the transfer, with the appropriate service center within 60 days of the date of this letter and attaching a copy of this letter to the election. This ruling is also contingent on the X stock held by Trust 3 being transferred to Trust 3A and on Trust 3(A) making a QSST election, effective on the date of the transfer, with the appropriate service center within 60 days of the date of this letter and attaching a copy of this letter to the election.

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. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation or whether Trust 3(A) or Trust 4 is eligible to be a 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.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

Beverly Katz  
Senior Technician Reviewer, Branch 2  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: (2)  
Copy of this letter  
Copy for § 6110 purposes