

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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LEGEND

Company	=
State	=
Trust	=
A	=
Date 1	=
Date 2	=
Date 3	=
Year 1	=
Year 2	=
m	=
Trustees	=

This letter responds to your letter dated June 5, 2001, and subsequent correspondence, written on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

Company is a State corporation that elected to be an S corporation effective Date 1. One of Company's shareholders is a Trust that owns m shares of Company stock. It is represented that Trust satisfies the requirements of a Qualified Subchapter S Trust (QSST) under § 1361(d)(2). Under the Trust's governing instrument, Trustees are not required to distribute annually all of Trust's income (within the meaning of § 643(b)) to A, Trust's current income beneficiary.

On Date 3, it was discovered that the Trustees had not distributed the Trust's income to A for the taxable years ending Year 1 and Year 2. Trustees were unaware that the failure to distribute all the income of a QSST would result in a termination of Company's S election. Upon discovery of the requirement, Trustees immediately distributed all of Trust's undistributed income to A on Date 3.

Company and its shareholders represent that the termination was not for tax avoidance purposes or retroactive tax planning. Company, and its shareholders, as well as Trust, have filed their returns for the taxable year ending Year 1 consistent with

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the treatment of Company as an S corporation, and have received extensions for filing their returns for the taxable year ending Year 2. Further, Company and its shareholders agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary.

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 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 for purposes of § 1361(b)(1)(B).

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), the trust is treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of the trust is treated as the owner of that portion of the trust that consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(3)(B) provides that, for purposes of § 1361(d), the term "qualified subchapter S trust" means a trust, 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 1361(d)(4)(B) provides that if any QSST ceases to meet any requirement of § 1361(d)(3)(B) but continues to meet the requirements of § 1361(d)(3)(A), the provisions of § 1361(d) shall not apply to the trust as of the first day of the first taxable year beginning after the first taxable year for which the trust failed to meet the requirements of § 1361(d)(3)(B).

Section 1362(d)(2)(A) provides that an election under § 1361(a) shall be terminated whenever 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

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any time during the period specified under § 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

Based on the facts submitted and the representations made, we conclude that Company's S corporation election terminated on Date 2 when Trustees of Trust failed to distribute all of Trust's income for the taxable years ending Year 1 and Year 2 to A. We also conclude that the termination was inadvertent under § 1362(f). Therefore, under § 1362(f), Company will be treated as continuing to be an S corporation from Date 2 to Date 3 and thereafter, provided that Company's S corporation election is valid and is not otherwise terminated under § 1362(d). If Company, Trust, or any of Company's shareholders fail to treat Company as described above, this ruling will 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, no opinion is expressed regarding whether Company is otherwise qualified to be an S corporation, or whether Trust is a valid QSST.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Under a power of attorney on file with this office, we are sending a copy of this letter to Company.

Sincerely yours,
Mary Beth Collins
Senior Technician Reviewer,
Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure (1)
Copy for section 6110 purposes