Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Legend

X   =

Trust =

State =

D1   =

D2   =

D3   =

Dear   :

This responds to a letter dated March 30, 2012, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

According to the information submitted and the representations made, X was incorporated on D1, under the laws of State. On D2, the Trust acquired X stock. X filed a timely election under § 1362(a) to be treated as an S corporation effective D3. On D3, the Trust was eligible to file an election pursuant to § 1361(d)(2) to be treated as a qualified subchapter S trust (QSST). However, no election was made to treat the Trust as a QSST. Therefore, the Trust was not an eligible shareholder and X's S corporation election was ineffective.

X represents that the circumstances resulting in the ineffectiveness of X's S election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X and its shareholders have filed their federal income tax returns consistent with having made a valid S corporation election in effect for X. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary. X represents that the sole income beneficiary of the Trust has reported all the income of the Trust on the beneficiary's Form 1040, U.S. Individual Income Tax Return since D3.

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

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1362(b)(1)(B), a trust, all of which is treated (under title 26, subtitle A, chapter 1, subchapter J, part I, subpart E of the United States Code) as owned by an individual who is a citizen or resident of the United States, may be an S corporation shareholder.

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) such trust will be treated as a trust described in § 1361(c)(2)(A)(i), and (B) 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 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of a QSST must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax returns the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(j)(6)(iii) provides that, if S corporation stock is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day the stock is transferred to the trust. If a C corporation has made an election under § 1362(a) to be an S corporation (S election) and, before that corporation's S election is in effect, stock of that corporation is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 1.1361-1(j)(7)(i) provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

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 first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. The termination is effective on and after the day of the cessation. Section 1362(d)(2)(B).

Section 1362(f) provides, in part, 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 for which the election was made or the termination occurred is a small business corporation, or (B) to acquire the required shareholder consents; and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of such 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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Based on the information submitted and the representations made, we conclude that X's D3 S corporation election was ineffective because X had an ineligible shareholder. We further conclude that the ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as an S corporation from D3 and thereafter, provided that X's election to be an S corporation was not otherwise ineffective and was not terminated under § 1362(d), so long as the beneficiary of the Trust files an effective QSST election effective D3, pursuant to the procedures set forth in § 1.1361-1(j)(6), with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to the QSST election.

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 or implied regarding X's eligibility to be an S corporation or the Trust's eligibility to be a 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. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to <u>X</u>'s authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of the letter
Copy for § 6110 purposes

cc: