Internal Revenue Service

Number: **200949032**
Release Date: 12/4/2009

Index Number: 1362.04-00

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:03
PLR-132506-09
Date:
August 24, 2009

LEGEND

Company =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Trust1 =

Trust2 =

Dear :

This letter responds to your letter dated June 12, 2009, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

Company incorporated in State on Date1. On Date2, Company filed Form 2553, Election by a Small Business Corporation, effective Date3. On Date4, all of Company's shares were transferred to Trust1, a wholly owned grantor trust qualified to hold shares of an S Corporation. On Date5, the assets of Trust1, including all of Company's shares, were transferred to Trust2.

On Date5, Trust2 was eligible to make an election to be treated as a qualified subchapter S trust ("QSST"). Due to inadvertence, no QSST election was ever filed for Trust2. Trust2 did not otherwise qualify as an eligible shareholder of an S Corporation. Thus, Company's S Corporation election terminated as of Date5.

Company represents that there was no intent to terminate Company's S corporation election and that the failure to file a QSST election was inadvertent and not motivated by tax avoidance or retroactive tax planning. For all taxable years, Company and Company's shareholders' income was reported consistent with Company qualifying as an S corporation. In addition, Company and Company's shareholders agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

LAW AND ANALYSIS

Section 1361(a)(1) 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 shareholder 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 a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1 of the Code) as owned by an individual who is a citizen or resident of the United States, is an eligible S corporation shareholder.

Section 1361(d)(1) provides that in the case of a qualified subchapter S trust 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).

Section 1361(d)(2) provides that a beneficiary of a qualified subchapter S trust (or his legal representative) may elect to have § 1361(d) apply.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term "qualified subchapter S trust" 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 the 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. A substantially separate and independent share of a trust within the meaning of § 663(c) shall be treated as a separate trust for purposes of this § 1361(d) and § 1361(c).

Section 1361(d)(4)(A) provides that if a qualified subchapter S trust ceases to meet any requirement of § 1361(d)(3)(A), the provisions of this § 1361(d) shall not apply to such trust as of the date it ceases to meet such requirement.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (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 so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agree to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that for purposes of § 1.1362-4(a) the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that Company's S corporation election was terminated on Date5, when stock in Company was transferred to Trust2, because Trust2 failed to timely file the required QSST election under § 1361(d)(2). We further conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), Company will be treated as continuing to be an S corporation on and after Date5, unless Company's S corporation election is otherwise terminated under § 1362(d), provided that the trustee of Trust2 files a QSST election with the appropriate service center within 60 days of the date of this letter to be effective Date5. 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 Company's eligibility to be an S corporation or Trust2's eligibility to be a QSST.

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

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

/s/
James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for Section 6110 purposes

cc: