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:B03
PLR-124839-09
Date: September 24, 2009

LEGEND

Company =

A =

B =

Trust =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to a letter dated May 13, 2009, submitted on behalf of Company, requesting inadvertent termination relief pursuant to § 1362(f) of the Internal Revenue Code.

FACTS

Company was incorporated under the laws of State on Date 1. Company elected to be treated as an S corporation effective Date 2. A was a shareholder of Company. On Date 3, A died. Pursuant to the terms of A's will, shares of Company stock were transferred from A's estate to the Trust, a testamentary trust, on Date 4.

Under the terms of the Trust, the sole beneficiary was A's spouse, B. Company represents that at all times the Trust satisfied the requirements to be treated as a qualified subchapter S trust ("QSST") under § 1361(d). However, an election under § 1361(d)(2) to treat Trust as a QSST was not timely filed. Therefore, Company's S election terminated two years after Date 4, on Date 5. B's federal income tax returns were filed consistent with Trust having a valid QSST election in effect on Date 5.

Company represents that Company and its shareholders have reported their income consistent with Company being an S corporation. Company also represents that the failure to file timely a QSST election for Trust was inadvertent and not motivated by tax avoidance or retroactive tax planning. Company further represents that, other than the failure to file a QSST election for Trust, Company has met the definition of a small business corporation since Date 2. Company and all of its shareholders consent and agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary under § 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)(B) provides that a "small business corporation" cannot 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, is a permitted shareholder of a small business corporation.

Section 1361(c)(2)(A)(iii) provides that a trust with respect to stock transferred to it pursuant to the terms of a will is a permitted shareholder, but only for the 2-year period beginning on the day on which the stock is transferred to it.

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 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 a beneficiary of a QSST (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 terminates on the earlier of the 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 distributes all of its assets to that 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, in part, that a small business corporation may elect to be an S corporation.

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 part, 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 such termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation for which the termination occurred and each person who was a shareholder in 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 termination period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based on the information submitted and representations made, we conclude that Company's S corporation election terminated on Date 5, when Trust became an ineligible shareholder. We further conclude that the termination was inadvertent within the meaning of § 1362(f).

Under § 1362(f), Company will be treated as if it were an S corporation from Date 2 and thereafter, provided the beneficiary, B, files a QSST election with an effective date of Date 5 with the appropriate service center within 60 days from the date of this letter, and Company's S corporation election was otherwise valid and not otherwise terminated under § 1362(d). Accordingly, Company'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 non-separately computed items of Company as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by Company as provided by § 1368. If Company or any of the shareholders fail to treat Company as described above, this ruling shall be void. A copy of this letter should be attached to the QSST election.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning whether Company was and is an S corporation for federal tax purposes. Furthermore, no opinion is expressed or implied concerning whether Trust meets the requirements of a QSST under § 1361(d)(3).

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.

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

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,
/s/
Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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