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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B01
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Date:
May 29, 2012

Legend

X =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

Trust5 =

Trust6 =

Trust7 =

Trust8 =

Trust9 =

Trust10 =

Trust11 =

Trust12 =

Trust13 =

Trust14 =

Individual1 =

Individual2 =

State =
Date1 =
Date2 =
Date3 =
Date4 =
Date5 =
Date6 =
w =
Year =

Dear :

This responds to a letter dated June 21, 2010, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State on Date1. X elected to be an S Corporation effective Date2.

Trust1 – Trust9 each filed an election be treated as a Qualified Subchapter S Trust ("QSST"), effective Date2. It was subsequently discovered that discovered that Trust1 – Trust9 were not qualified to make QSST elections but Trust1 – Trust8 were qualified to make Electing Small Business Trust ("ESBT") elections. Trust9 included a nonresident alien as a potential current beneficiary, disqualifying Trust9 from treatment as an ESBT. X represents that no distributions were made to a nonresident alien beneficiary and that all shares in X held by Trust9 were redeemed on Date5.

Trust10 was a permitted shareholder on Date2, but inadvertently failed to file a QSST election effective Date3.

Trust11 and Trust12 filed QSST elections effective Date2 but were not established as true trusts. Instead, Individual1 and Individual2, the intended beneficiaries of Trust11 and Trust12 respectively, owned the X stock directly and filed federal income tax returns treating themselves as the owners of the X stock.

On Date4, Trust13 and Trust14 became shareholders of X and each filed an election to be treated as a QSST. Trust13 and Trust14 are eligible to be ESBTs but not QSSTs.

X represents that the failure to make the appropriate ESBT and QSST elections for the trusts, as well as the other errors and circumstances that led to the possible ineffectiveness of its S corporation election were inadvertent and not motivated by tax avoidance or retroactive tax planning. In addition, X and X's shareholders agree to make any adjustments consistent with the treatment of X 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) 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) provides that the term "small business corporation" means 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 one class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), 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.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1362(b)(1)(B), an ESBT is a permitted shareholder of a small business corporation.

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), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, 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 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(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 (B) 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 is a small business corporation; 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.

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. In the case of stock held by an ineligible shareholder that causes an inadvertent termination or invalid election for an S corporation under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of the S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent the loss of any revenue due to the holding of stock by an ineligible shareholder (for example, a nonresident alien).

CONCLUSION

Based solely on the representations made and the information submitted, we conclude that X's S corporation election was ineffective as of Date2 because Trust1 – Trust9 were ineligible shareholders. We conclude that the ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f). Further, had X's election been effective, X's election would have terminated on Date3, when Trust10 became an ineligible shareholder, and on Date4, when X stock was transferred to Trust13 and Trust14, also ineligible shareholders. We conclude that these subsequent potential terminations were also inadvertent within the meaning of § 1362(f).

Accordingly, we conclude that, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date2 and thereafter, assuming X's S election is otherwise valid and not otherwise terminated under § 1362(d).

We further conclude that the shares held by in X held by Trust11 and Trust12 are to be treated as held directly by Individual1 and Individual2, respectively, effective Date2.

This ruling is contingent on X and its shareholders treating X as having been an S corporation for the period beginning Date2 and thereafter. The trustees of Trust1 – Trust9 must file appropriate ESBT elections effective Date2 with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to each ESBT election. The trustees of Trust13 – Trust14 must file appropriate ESBT elections effective Date4 with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to each ESBT election. The beneficiary of Trust10 must file a QSST election effective Date3 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.

Further, X and all of its current and former shareholders must file any necessary original or amended returns for Year and all subsequent years consistent with the relief granted in this ruling within 120 days of the date of this letter. Accordingly, in determining their respective income tax, all the shareholders of X must include their pro-rata share of the separately stated items of income, loss, deduction, or credit and nonseparately computed items of income and loss of X as provided in § 1366, make adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368 within 120 days of the date of this letter.

Finally, as an adjustment under § 1362(f)(4), a payment of $w and a copy of this letter must be sent to the following address: Internal Revenue Service, Cincinnati Service Center, 201 West Rivercenter Blvd., Covington, KY 14011, Stop 31, Terri Lackey, Manual Deposit. This payment must be sent no later than Date6.

Except as specifically ruled upon above, we express or imply no opinion as to the federal income tax consequences of the facts described above under any other provision of the Code. In particular, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation, whether Trust1 – Trust9 and Trust13 – Trust14 are eligible to be ESBTs under § 1361(e), or whether Trust 10 is eligible to be a QSST under § 1361(d).

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 your authorized representative.

Sincerely,

Faith P. Colson
Faith P. Colson
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: