

**Internal Revenue Service**

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Washington, DC 20224

Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-157123-04

Date:

January 10, 2005

Legend

X =

SH1 =

SH2 =

SH3 =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

Trust5 =

Trust6 =

B1 =

B2 =

B3 =

B4 =

B5 =

B6 =

State =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

Dear :

This responds to a letter dated October 26, 2004, sent by your authorized representative, requesting inadvertent termination relief under §1362(f) of the Internal Revenue Code.

#### STATEMENT OF FACTS

According to the information submitted and representations therein, X was incorporated on D1 pursuant to the laws of State. X made an election to be treated as an S corporation effective D1.

On D2, SH1 transferred a portion of SH1's shares to Trust1 for the benefit of B1. SH1 further transferred an additional portion of SH1's shares to Trust2 for the benefit of B2. A qualified subchapter S trust ("QSST") election was not filed by B1 or B2.

On D3, SH2 transferred a portion of SH2's shares to Trust3 for the benefit of B3 and B4. Also on D3, SH3 transferred a portion of SH3's shares to Trust4 for the benefit of B5.

and B6. On D4, Trust4 distributed all of its shares of X to two sub-trusts, Trust5 and Trust6. Accordingly, subsequent to D4, Trust4 was no longer a shareholder of X.

With respect to the transfer of X's shares to Trust1 and Trust2, SH1 represents that despite being advised by an attorney and an accountant, SH1 was not advised to direct the beneficiaries of each trust to file a QSST election on behalf of each trust. Consequently, a QSST election for Trust1 and Trust2 was not filed on D2.

With respect to the transfer of X's shares to Trust3, SH2 represents that SH2 in good faith believed that because SH1 had transferred a portion of SH1's shares to a trust after consultation with an attorney and accountant, a similar transfer by SH2 would not cause the termination of X's status as an S corporation. SH2 further represents that SH2 relied upon an accountant who failed to advise SH2 that Trust3 was an ineligible S corporation shareholder.

With respect to the transfer of X's shares to Trust4, and subsequently sub-trusts Trust5 and Trust6, SH3 represents that SH3 in good faith believed that because SH1 had transferred a portion of SH1's shares to a trust after consultation with an attorney and accountant, a similar transfer by SH3 would not cause the termination of X's status as an S corporation. SH3 further represents that SH3 relied upon an accountant and upon SH2 both of whom failed to advise SH3 that Trust4, Trust5, and Trust6 were ineligible S corporation shareholders.

X, SH1, SH2, and SH3 represent that in a reasonable period of time after discovery of the ineligibility of each trust as a shareholder, steps were taken so that X was again a small business corporation. On D5, two weeks after learning that Trust1 and Trust2 were ineligible S corporation shareholders, B1 and B2 filed late QSST elections. On D6, two days after learning that Trust3, Trust5, and Trust6 were ineligible shareholders, each trust distributed all of the shares of X to the individual beneficiaries of each respective trust, all of whom are domestic individuals.

It is further represented that at all relevant times, X and its shareholders treated X as an S corporation and filed their tax returns accordingly. X and all of its shareholders for the relevant period have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

#### 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. Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate and other than a trust described in § 1362(c)(2)) 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 § 1361(b)(1)(B), trusts that may be shareholders of an S corporation include a trust all of which is treated as owned by an individual who is a citizen or resident of the United States.

Section 1361(d)(1) provides in part 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)(3) provides that the term “qualified subchapter S trust” (QSST) means a trust - (A) the terms of which require that - (i) during the life of 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.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides 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 consent, 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 the termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, 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 termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts submitted and the representations set forth above, we conclude that (1) X's election to be treated as an S corporation terminated on D2 when SH1 transferred a portion of SH1's shares to ineligible shareholders, and (2) had X's S corporation not terminated on D2, it would have terminated on D3 when SH2 and SH3 transferred a portion of their shares to Trust3 and Trust4 respectively. We also

conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2, and thereafter, provided that the beneficiary of Trust1 (B1) and the beneficiary of Trust2 (B2) each file a QSST election for their respective trusts with the appropriate service center, effective D2, within 60 days of the date of this letter and provided that X's S corporation election is not otherwise terminated under § 1362(d). A copy of this letter should be attached to the election.

In addition, this ruling is contingent upon the distribution of stock held by Trust3, Trust5, and Trust6 to eligible shareholders on or before the date which is sixty days after the date of this letter.

Except as specifically provided herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether X is an S corporation for federal tax purposes and whether Trust1 and Trust2 are QSSTs under § 1361(d).

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

/s/ David R. Haglund

David R. Haglund  
Senior Technician Reviewer, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

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

cc: