

Dear -----:

This letter responds to a letter dated July 1, 2003, and subsequent correspondence written on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated on d1 under the laws of State, and elected to be treated as an S corporation effective d2. The shareholders of X during the relevant period were the Shareholders. Trust received shares of X on d3. A, the income beneficiary of Trust, intended to file an election for Trust to be treated as a qualified subchapter S trust (QSST) under § 1361(d). However, A did not timely file the appropriate election under § 1362(d)(2).

X represents that X has filed its federal income tax returns as though X were an S corporation since d2. X represents that there was no intent to terminate X's S corporation election and that the failure to file timely the QSST election for Trust was not motivated by tax avoidance or retroactive tax planning. X and its shareholders agree to make any necessary adjustments as may be required by the Commissioner consistent with the treatment of X as an S corporation.

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 corporation and which does not (A) have more than 75 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)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the 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), 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 that 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 the beneficiary's legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) may be effective up to 15 days and two months before the date of the election.

Section 1362(f), provides 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 and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that 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. In the case of a transfer of stock to an ineligible shareholder that causes an inadvertent termination under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of an S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent any loss of revenue due to a transfer of stock to an ineligible shareholder (e.g., a transfer to a nonresident alien).

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's election to be treated as an S corporation was terminated on d3, when X's shares were transferred to Trust, an ineligible S corporation shareholder. We also conclude that the termination was inadvertent within the meaning of § 1362(f). Provided that X's S corporation election is valid and is not otherwise terminated under § 1362(d), and provided that A files a QSST election for Trust with the appropriate service center within 60 days from the date of this letter with an effective date of d3, X will be treated as continuing to be an S corporation from d3, and thereafter. 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, we express or imply no opinion whether X is otherwise qualified to be an S corporation, or whether Trust is otherwise a valid QSST.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

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

Sincerely yours,

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

Enclosures (2):

Copy of this letter

Copy for § 6110 purposes