

Internal Revenue Service

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Person To Contact:
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Telephone Number:

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April 02, 2014

LEGEND

X =

Sub 1 =

Sub 2 =

Sub 3 =

A =

Trust =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This responds to a letter dated December 26, 2013, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted and representations within, after incorporating under the laws of State, X elected to be treated as an S corporation effective Date 1. Also effective Date 1, X elected to treat Sub 1, Sub 2, and Sub 3 as qualified subchapter S subsidiaries (QSubs). A transferred shares of X to Trust on Date 2. Trust was a qualifying shareholder of an S corporation pursuant to § 1361(c)(2)(A)(i). On Date 3, A died and Trust continued as an eligible S corporation shareholder under § 1361(c)(2)(A)(ii).

X represents Trust was eligible to be an ESBT within the meaning of 1361(e). However, trustee of Trust failed to make a timely ESBT election under § 1361(e)(3). Consequently, Trust was no longer a permissible S corporation shareholder and, as a result X's S corporation election terminated on Date 4. Also terminated effective Date 4 was X's QSub elections. As of Date 5, all of X's shares held by Trust have either been redeemed or distributed elsewhere.

X represents that the circumstances resulting in the termination of X's S corporation election and QSub elections were inadvertent and not motivated by tax avoidance or retroactive tax planning. X further represents that it has filed returns consistent with its status as an S corporation and Sub 1, Sub 2, and Sub 3 as qualified subchapter S subsidiaries (QSubs). X and its shareholders have agreed to make any adjustments the Commissioner may require, consistent with the treatment of X as an S corporation and Sub 1, Sub 2, and Sub 3 as qualified subchapter S subsidiaries (QSubs).

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 100 shareholders, (B) have as a shareholder a person (other than an estate and other than a trust described in subsection (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(b)(3)(B) defines a QSub as any domestic corporation which is not an ineligible corporation if 100 percent of the stock of the corporation is held by the S corporation, and the S corporation elects to treat the corporation as a QSub.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1361(b)(1)(B), trusts that may be shareholders include an electing small business trust.

Section 1361(e)(1)(A) provides that an "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than an (I) individual, (II) an estate, or (III) an organization described in paragraph (2), (3), (4), or (5) of § 170(c) or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary; (ii) no interest in such trust was acquired by purchase, and (iii) an election under this subsection applies to such trust.

Section 1361(e)(1)(B) provides that the term "electing small business trust" shall not include (i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides in part that the trustee of the trust must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of paragraph (m)(2)(ii) of this section.

Under § 1.1361-1(m)(2)(iii), if S corporation stock is transferred to a trust, the ESBT election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

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 consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the 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 § 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 the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we find that X's S corporation election and its QSub elections were terminated on Date 4 because Trust was no longer an eligible shareholder of X. However, we deem these terminations to be inadvertent within the meaning of § 1362(f). Therefore, we conclude that X will be treated as an S corporation from Date 4 and thereafter, provided that X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d). Furthermore, Sub 1, Sub 2, and Sub 3 will be treated as QSubs from Date 4 and thereafter, provided they are otherwise eligible to be treated as QSubs.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed regarding whether X otherwise qualifies as an S corporation, and Sub 1, Sub 2, and Sub 3 otherwise qualify as QSubs.

This ruling is directed only to the taxpayer who requested 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, a copy of this letter is being sent to X's authorized representative.

Sincerely,

David R. Haglund
David R. Haglund
Branch Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter.

Copy of this letter for §6110 purposes.