

## Internal Revenue Service

Number: **201545015**

Release Date: 11/6/2015

Index Number: 1361.01-03, 1361.03-02,  
1361.03-03, 1362.04-00

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:B01

PLR-115132-14

Date:

6/5/2015

## LEGEND

X =

Individual A =

Individual B =

Individual C =

State =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 3-A =

Trust 3-B =

Trust 3-C =

Trust 3-D =

Trust 3-E =

Trust 3-F =

Trust 4 =

Year 1 =

Year 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

\$a =

Dear :

This ruling is in response to a letter dated March 28, 2014, 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, we understand the facts to be as follows. X incorporated under the laws of State in Year 1 and filed a timely election to be treated as an S Corporation effective Date 1.

Trust 1 was established and funded with shares of X on Date 2. X represents that Trust 1 was qualified to be an electing small business trust (ESBT). However, the trustee of Trust 1 inadvertently failed to file a timely ESBT election.

Trust 2 was established on Date 3 and funded with shares of X on Date 4. The trustee of Trust 2, despite making a timely ESBT election, inadvertently omitted several potential current beneficiaries.

On Date 5, a nonresident alien married Individual A, a beneficiary of Trust 2, and became a potential current beneficiary, disqualifying Trust 2 from ESBT treatment. X represents that no distributions from Trust 2 were ever made to the nonresident alien or Individual A, and that the nonresident alien is no longer a potential current beneficiary of Trust 2.

Trust 3 was established on Date 6 and provided for the establishment of six (6) separate trusts, one for each child of the donor (i.e., Trust 3-A, Trust 3-B, Trust 3-C, Trust 3-D, Trust 3-E, and Trust 3-F). On Date 1, the trustees of the six (6) trusts made timely ESBT elections correctly listing each potential current income beneficiary. However, the trustees failed to list the spouse and issue of each potential current income beneficiary.

Trust 4, a shareholder of X, filed a qualified subchapter S trust (QSST) election on Date 7 but failed to include the date on which the stock of the X was transferred to the trust. Furthermore, Trust 4 failed to provide information demonstrating its eligibility to make such an election.

Finally, in regard to X's S corporation election, X is unable to locate a consent form from Individual C, one of X's shareholders. However, X believes that Individual C consented to the election at the time it was made. Nevertheless, X would like Individual C to submit a signed consent form.

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 inadvertent

ineffectiveness and/or termination 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 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 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 an S corporation.

Section 1361(e)(1)(A) provides that the term ESBT means any trust if (i) such trust does not have as a beneficiary any person other than an individual, an estate, or a qualifying charitable organization, (ii) no interest in the trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1.1361-1(m)(4)(i) provides that, for purposes of determining whether a corporation is a small business corporation within the meaning of § 1361(b)(1), each potential current beneficiary of an ESBT generally is treated as a shareholder of the corporation. Subject to the provisions of § 1.1361-1(m)(4), a potential current beneficiary generally is, with respect to any period, any person who at any time during such period is entitled to, or in the discretion of any person may receive, a distribution from the principal or income of the trust. No person is treated as a potential current beneficiary solely because that person holds any future interest in the trust.

Section 1.1361-1(m)(5)(iii) provides that if a potential current beneficiary of an ESBT is not an eligible shareholder of a small business corporation within the meaning of §

1361(b)(1), the S corporation election terminates. For example, the S corporation election will terminate if a nonresident alien becomes a potential current beneficiary of an ESBT. Such a potential current beneficiary is treated as an ineligible shareholder beginning on the day such person becomes a potential current beneficiary, and the S corporation election terminates on that date.

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)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one 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 beneficiary in the trust shall terminate 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 shall distribute 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 one individual who is a citizen or resident of the United States.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) (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 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 (A) so that the corporation is a small business corporation or (B) to acquire the required 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 such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) 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 that 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 representations made and the information submitted, we conclude that X's S corporation election was ineffective because it had ineligible shareholders on Date 1. Additionally, if X's S corporation had been effective, it would have terminated due to the errors described above. We further conclude that the potential ineffectiveness and terminations were inadvertent within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 1 and thereafter, assuming X's S corporation election is otherwise valid and is not otherwise terminated.

This ruling is contingent on X and its shareholders treating X as having been an S corporation for the period beginning Date 1 and thereafter. This ruling is also contingent on the following: Within 120 days from the date of this letter, (1) an adjustment payment in the amount of \$a 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 41011, Stop 31, Terri Lackey, Manual Deposit; (2) The trustee of Trust 1 must file an ESBT election effective Date 2 with the appropriate service center; (3) the trustee of Trust 2 must file an ESBT election effective Date 1 with the appropriate service center; (4) the trustees of Trust 3-A, Trust 3-B, Trust 3-C, Trust 3-D, Trust 3-E, and Trust 3-F must file ESBT elections effective Date 1 with the appropriate service center; (5) the beneficiary of Trust 4, Individual B, must file a QSST election effective Date 7 with the appropriate service center; (6) Individual C, a shareholder of X, must file a signed consent form effective Date 1 with the appropriate service center; and (7) X

and all of its current and former shareholders must file any necessary original or amended returns for Year 2 and all subsequent years consistent with the relief granted in this ruling. A copy of this letter should be attached to all required ESBT and QSST elections. If these conditions are not met, then this ruling is null and void.

Except as specifically ruled upon, we express or imply no opinion as to the federal tax consequences of the previously stated facts 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 Trust 1, Trust 2, Trust 3, Trust 3-A, Trust 3-B, Trust 3-C, Trust 3-D, Trust 3-E, and Trust 3-F are eligible to be ESBTs under § 1361(e), or whether Trust 4 is eligible to be a QSST 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.

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,

Joy C. Spies

Joy C. Spies  
Senior Technician Reviewer, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes