

Internal Revenue Service

Number: **201601002**

Release Date: 12/31/2015

Index Number: 1362.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-109694-15

Date:

September 11, 2015

LEGEND:

X =

A =

B =

Trust 1 =

Trust 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Years =

\$n =

Dear

This responds to a letter dated February 22, 2015, and subsequent correspondence, submitted on behalf of X, requesting relief pursuant to § 1362(f) of the Internal Revenue Code (the Code).

Facts

The information submitted states that X was incorporated under the laws of State on Date 1. X filed a timely election under § 1362(a) to be taxed as an S corporation effective Date 2. On Date 2, Trust 1 owned shares of X stock. X represents that Trust 1 was qualified to be an Electing Small Business Trust (ESBT), within the meaning of § 1361(e). However, no election was made under § 1361(e)(3) to treat Trust 1 as an ESBT. Consequently, Trust 1 was an ineligible shareholder, and, as a result, X's S corporation election was ineffective.

Additionally, on Date 2, A, an individual, owned shares of X stock. On Date 3, A contributed the shares of X stock to Trust 2, a revocable trust. A died on Date 4. Pursuant to the terms of Trust 2, after A's death, individual B became the primary beneficiary of Trust 2. X represents that Trust 2 is eligible to elect to be a qualified subchapter S trust (QSST). However, no QSST election was filed on behalf of Trust 2 and therefore X's S corporation election would have terminated on Date 5 (if it had not already made an ineffective election) because Trust 2 was an ineligible shareholder.

X represents that the circumstances resulting in the ineffectiveness of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X and its shareholders have filed their federal income tax returns consistent with having a valid S corporation election in effect for X. X and its shareholders have agreed 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) of the Code 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 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 1 class of stock.

Section 1361(c)(2)(A)(i) provides that, for the purposes of § 1362(b)(1)(B), a trust all of which is treated (under title 26, subtitle A, chapter 1, subchapter J, part I, subpart E of the United States Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation.

Section 1361(c)(2)(A)(v) provides that an ESBT, within the meaning of § 1361(e)(1), may be a shareholder for purposes of § 1361(b)(1)(B). The trustee of the trust makes the ESBT election pursuant to § 1361(e)(3). Section 1.1361-1(m)(2)(i) provides that the trustee of an ESBT 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 § 1.1361-1(m)(2)(ii).

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), (A) such trust will be treated as a trust described in § 1361(c)(2)(A)(i), and (B) 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 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the tax 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 paragraph (2) or (3) of § 1362(d); (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 event resulting in the ineffectiveness, 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 § 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, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) of the Income Tax Regulations 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.

Conclusion

Based solely on the facts submitted and representation made, we conclude X's S election was invalid on Date 2 upon the failure to timely file an ESBT election for Trust 1. We further conclude that the invalid election was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will continue to be treated as an S corporation on and after Date 2, unless X's S corporation is otherwise terminated under § 1362(d). Moreover, had X's S corporation been effective, it would have terminated on Date 5 upon the failure of the income beneficiary to file a QSST election for Trust 2. Similarly, this terminating event would have been an inadvertent termination within the meaning of § 1362(f).

This ruling is conditioned on: 1) the trustee of Trust 1 filing an ESBT election effective Date 2 with the appropriate service center within 120 days of the date of this letter, and 2) B, as the income beneficiary of Trust 2, filing a QSST election for Trust 2 effective Date 5 within 120 days from the date of this letter. A copy of this letter should be attached the ESBT and QSST elections.

In addition, this ruling is conditioned on: 1) Trust 1 filing any amended returns and making adjustments that are necessary to properly reflect the treatment of Trust 1 as an ESBT for Years taxable years, and 2) Trust 2 filing any amended returns and making adjustments that are necessary to properly reflect the treatment of Trust 2 as a QSST for Years taxable years.

Furthermore, as an adjustment under § 1362(f)(4), this ruling is conditioned on the payment of \$n and a copy of this letter ruling must be sent to the address: Internal Revenue Service, Cincinnati Service Center, 201 West Rivercenter Blvd., Covington, KY 41011, Stop 31, Terri Lackey, Manual Deposit. The payment and copy of this letter must be sent no later than Date 6.

If all of the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must send a notification that its S corporation election has terminated to the service center with which X's S corporation was filed.

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

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

Sincerely,

Laura C. Fields
Senior Technician Reviewer, Branch 1
(Passthroughs & Special Industries)

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