

Internal Revenue Service

Department of the Treasury
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November 30, 2015

LEGEND

X =

A =

B =

GRAT =

Trust =

State =

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to a letter dated May 15, 2015, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that X was incorporated in State on Date 1 and elected to be treated as an S corporation effective Date 1. On Date 2, A created GRAT

and contributed X stock to GRAT. GRAT was treated as a grantor trust under subpart E of part I of subchapter J of chapter 1 of the Code. On Date 3, GRAT terminated, and X stock was distributed to Trust, a trust created under the terms of GRAT.

X represents that Trust satisfied all of the requirements of a qualified subchapter S trust ("QSST") within the meaning of § 1361(d)(3). However, B (the income beneficiary of Trust) failed to timely file a QSST election under § 1361(d)(2)(A). As a result, X's S corporation election terminated on Date 3.

X represents that the termination of X's S corporation election was 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 for all relevant periods, and that its shareholder has filed consistent with having a valid QSST election in effect as appropriate. 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 Commissioner with respect to the period specified by § 1362(f).

LAW

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(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) provides, in part, that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not 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.

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 1 of subchapter J of chapter 1 of the Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1) provides that if a QSST's beneficiary makes an election under § 1361(d)(2), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, 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 § 1362(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means a trust (A) the terms of which require that (i) during the life of the 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 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 1.1361-1(j)(6)(iii) of the Income Tax Regulations provides that if S corporation stock is transferred to a trust, the QSST 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 (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.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the 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 § 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 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 representations made, we conclude that X’s S corporation election terminated on Date 3 as a result of the failure of the beneficiary of Trust to make the election required under § 1361(d)(3)(A). However, we conclude that the termination on Date 3 was inadvertent within the meaning of § 1362(f).

Accordingly, under § 1362(f), X will be treated as continuing to be an S corporation on and after Date 3, provided that X's S corporation election was valid and not otherwise terminated under § 1362(d), and that B makes the required QSST election for Trust with an effective date of Date 3. This election must be filed with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to the QSST election. If B makes the election as instructed herein, Trust (as a QSST with B as the beneficiary) shall be treated as owning the stock of X from Date 3. Accordingly, the shareholders of X must include in income their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make an adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this letter ruling will be null and void.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provisions of the Code. Specifically, we express or imply no opinion as to whether X is otherwise eligible to be treated as an S corporation, or whether Trust is otherwise a QSST within the meaning of § 1361(d)(3).

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

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

In accordance with a power of attorney on file with this office, we are sending copies of this letter to your authorized representatives.

Sincerely,

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

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

cc: