

Internal Revenue Service

Number: **201623002**

Release Date: 6/3/2016

Index Number: 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:B3

PLR-127780-15

Date: February 4, 2016

LEGEND

X =

Y =

Trust 1 =

Trust 2 =

A =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to a letter dated August 10, 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 2. In Date 3, Trust 1, a shareholder of X, contributed shares of X to Y, a partnership, an ineligible S corporation shareholder under § 1361(b)(1)(B). As a result, X's S corporation election terminated Date 3.

In addition, shares of stock in X are held by Trust 2. Trust 2 was a grantor trust described in § 1361(c)(2)(A)(i) of which A was the deemed owner. A died on Date 4. Relative to A's shares of X stock, Trust 2 qualified under § 1361(c)(2)(A)(ii) as an eligible shareholder for two years from A's date of death. However, Trust 2 continued to hold the X stock after the two-year period. According to X, Trust 2 qualifies as an electing small business trust ("ESBT"), but its trustee made no ESBT election. As a result, X's S corporation election would have terminated Date 5 had the election not already terminated Date 3.

X represents that the termination of X's S corporation election was not motivated by tax avoidance or retroactive tax planning. 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 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), the following trust may be an S corporation shareholder: 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.

Section 1361(c)(2)(A)(ii) provides that for purposes of § 1361(b)(1)(B), the following trust may be an S corporation shareholder: a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death may be a shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT may be an S corporation shareholder.

Section 1361(e)(1)(A) provides that for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), 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 § 1361(e) applies to such trust. 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 taxable years of such trust unless revoked with the consent of the Secretary.

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 (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 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 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 representations made, we conclude that X's S corporation election terminated on Date 3 because X had an ineligible shareholder. 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). As a condition to this ruling, Y must distribute all of its X stock to eligible shareholders within 120 days of the date of this letter.

We further conclude that X's S corporation election would have terminated on Date 5 (after the two-year period beginning on H's death) due to the trustee's failure to make an ESBT election for Trust 2 had the election not already terminated Date 3. We also conclude that such termination would have constituted an inadvertent termination within the meaning of § 1362(f). Accordingly, X will be treated as continuing to be an S corporation from Date 5, and thereafter, provided that its S corporation election was otherwise valid and was not otherwise terminated under § 1362(d). Moreover, relative to A's shares of X stock, Trust 2 will be treated as an ESBT from Date 5, and thereafter, provided the trustee of Trust 2 files an ESBT election for Trust 2 with the appropriate service center, effective Date 5, within 120 days of the date of this letter. A copy of this letter should be attached to the election.

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 2 is otherwise eligible to be treated as an ESBT within the meaning of 1361(e)(1)(A).

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) of the Code 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 a copy of this letter to your authorized representatives.

Sincerely,

Richard T. Probst
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes