

Internal Revenue Service

Number: **201702007**
Release Date: 1/13/2017
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:B01
PLR-110513-16

Date:
September 22, 2016

Legend

X =

Y =

State =

Trust =

Date 1 =

Date 2 =

Year 1 =

Dear :

This responds to a letter dated March 29, 2016, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X is a State corporation that was incorporated in Year 1 and that elected to be an S corporation effective upon incorporation. Y is a State corporation that was incorporated on Date 1 and was at all

times wholly-owned by X. X elected to treat Y as a Qualified Subchapter S Subsidiary (QSub) effective upon Y's incorporation.

On Date 2, Trust acquired shares of X stock. However, the trustee of Trust failed to make an ESBT election effective Date 2 in a timely manner. Thus, on Date 2, Trust ceased to qualify as an eligible S corporation shareholder, and X's subchapter S election terminated. X represents that, as of Date 2 and afterward, Trust was eligible to be an electing small business trust (ESBT).

X represents that the failure to file the ESBT election for Trust was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X further represents that X has filed its income tax returns consistently with having a valid S corporation election in effect for all taxable years since Date 2. 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) 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)(B) provides that, for purposes of subchapter S, 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(b)(3)(A) generally provides that a QSub shall not be treated as a separate corporation and all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) defines a "qualified subchapter S subsidiary" (QSub) as a domestic corporation which is not an ineligible corporation, if 100 percent of the stock of the corporation is owned by the S corporation, and the S corporation elects to treat the corporation as a qualified subchapter S subsidiary.

Section 1361(c)(2)(A)(v) provides that, for the purposes of § 1362(b)(1)(B), an ESBT may be an S corporation shareholder.

Section 1361(e) defines an ESBT. Section 1361(e)(1)(A) provides that, except as provided in § 1362(e)(2)(B), an ESBT 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)(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 taxable years of such trust unless revoked with the consent of the Secretary.

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 1.1361-1(m)(2)(iii) provides that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a QSST election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1.1361-3(a) prescribes the time and manner for making an election to be classified as a QSub.

Section 1.1361-3(a)(4) provides that an election may be effective up to two months and 15 days prior to the date the election is filed or not more than 12 months after the election is filed. The proper form for making the election is Form 8869, Qualified Subchapter S Subsidiary Election.

Section 1.1361-5(a)(1) provides that the termination of a QSub election is effective at the close of the last day of the parent’s last taxable year as an S corporation if the parent’s S corporation election terminates under § 1.1362-2.

Section 1362(a) of the Code 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 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. The termination is effective on and after the day of the termination.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) by any corporation was terminated under § 1362(d)(2) or § 1361(b)(3)(C); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation or a QSub, as the case may be; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

Conclusion

Based solely on the information submitted and the representations made, we conclude that X's S corporation election and Y's QSub election terminated on Date 2, when Trust became an ineligible shareholder. We further conclude that the termination of X's S corporation election was an inadvertent termination within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation and Y will be treated as QSub from Date 2 and thereafter, provided that X's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d).

This ruling is contingent on Trust making a valid ESBT election, effective Date 2, with the appropriate service center within 120 days after the date of this letter. This ruling is also contingent on Trust filing an income tax return, if it has not already done so, for each of its open tax years consistent with its status being an ESBT no later than 180 days after the date of this letter. Provided that this election is made and these returns are filed, from Date 2 and thereafter, Trust will be treated as an ESBT under § 1361(e), provided that Trust's ESBT election was otherwise valid and Trust otherwise continued to qualify as a valid ESBT.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be an S corporation, whether Y is otherwise eligible to be a QSub, or whether Trust otherwise qualifies as a valid ESBT.

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

Sincerely,

Faith P. Colson

Faith P. Colson
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for §6110 purposes