

## Internal Revenue Service

Number: **201721004**

Release Date: 5/26/2017

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:B03

PLR-127058-16

Date:

February 23, 2017

X =

Date 1 =

State =

Trust =

A =

X =

Y =

Year 1 =

Year 2 =

Year 3 =

Date 3 =

Dear :

This responds to a letter dated August 29, 2016, and supplemental information, submitted on behalf of X by X's authorized representative, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

### FACTS

According to the information submitted and representations made, X was incorporated on Date 1 under the laws of State. Effective Date 1, X elected to be taxed as an S corporation under § 1362 of the Code.

X's shares were originally held by Trust. Trust was settled by A on Date 1. Trust's beneficiaries inadvertently failed to make an election under § 1361(d)(2) to treat Trust as a qualified subchapter S trust (QSST), but they intended to make the election effective Date 1.

Trust has X beneficiaries. Each beneficiary has a separate and independent interest in Trust within the meaning of § 663(c). Trust's trust agreement requires that, with respect to each separate and independent interest in Trust, there is only one income beneficiary and any corpus distributed during the life of such income beneficiary may be distributed only to such beneficiary. Further, the income interest of the current income beneficiary of each separate and independent interest in Trust terminates on the earlier of the beneficiary's death or termination of the Trust, and upon the termination of Trust during the life of the current income beneficiary, Trust must distribute all of its assets to that beneficiary.

From Year 1 through Year 2, Trust was inadvertently treated as a complex trust because Trust did not distribute all of its income to Trust's beneficiaries. All income was reported and all tax was paid at the trust level.

On Date 2, Trust's new accounting firm discovered the incorrect treatment of Trust. During this time, it was also discovered that a QSST election had never been filed on behalf of Trust.

X represents that its S corporation election termination was inadvertent and was not motivated by tax avoidance or retroactive tax planning. Trust has agreed to file amended returns consistent with being a QSST. Further, X and its shareholders represent that they will make any adjustments required as a condition of obtaining relief under the inadvertent termination rule provided in § 1362(f) that may be required by the Secretary.

### 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) defines “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 one class of stock.

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 of an S corporation.

Section 1361(d)(3) defines “qualified subchapter S trust” (QSST) as 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 the 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 section 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. A substantially separate and independent share of the trust within the meaning of § 663(c) shall be treated as a separate trust for purposes of §§ 1361(c) and (d).

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 shall be treated as a trust described in § 1361(c)(2)(A)(i), (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, and (C) for purposes of applying §§ 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust shall be treated as a disposition by such beneficiary.

Section 1361(d)(2) provides that a beneficiary of a qualified subchapter S trust (or his legal representative) may elect to have § 1361(d)(1) apply. An election under § 1362(d)(2) shall be made separately with respect to each corporation the stock of which is held by the trust.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will 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 that if an election under § 1362(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) and the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, and no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, steps were taken so that the corporation for which the election was made is a small business corporation, and the corporation for which the election was made 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 as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that the determination of whether an invalid S corporation election 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 invalid election was inadvertent. The fact that the invalidity of the election was not reasonably within the control of the corporation or the fact that the circumstances took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such circumstance, tends to establish the invalidity of the election was inadvertent.

### CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election was ineffective on Date 1 due to the beneficiaries' inadvertent failure to make a QSST election for Trust. Pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 1.

This ruling is contingent upon, within 120 days from the date of this letter, each beneficiary filing with the appropriate service center an election to treat Trust as QSST effective from Date 1 with respect to each beneficiary's separate share of Trust. This ruling is also contingent upon the trustee filing, within 120 days from the date of this letter, amended returns for Year 2 and Year 3 to conform with Trust's treatment as a QSST from Date 1. A copy of this letter should be attached to the QSST election and the amended returns.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other

provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation, or Trust's eligibility to be a QSST.

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

Pursuant to the power of attorney on file with this office, we are sending a copy 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