

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Date:
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LEGEND

Company =

State =

A =

B =

C =

D =

E =

F =

G =

H =

J =

K =

Trust 1 =

Trust 2 =

Beneficiary =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

a =

b =

c =

d =

e =

f =

h =

i =

k =

m =

n =

o =

p =

r =

s =

t =

u =

v =

w =

x =

Dear :

This responds to a letter dated November 14, 2016, and subsequent correspondence, submitted on behalf of Company by Company's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted, Company was incorporated under the laws of State on Date 1. Company attempted to elect to be treated as an S corporation effective Date 2.

Prior to Date 2, shares of Company were transferred to Trust 1. Company represents that Trust 1 complies with the requirements for a qualified subchapter S trust (QSST) under § 1361(d)(3). However, Trust 1's QSST election was inadvertently signed by the trustee of Trust 1, rather than by Beneficiary, the beneficiary of Trust 1. Additionally, the trustee of Trust 1, not Beneficiary, signed the consent for Form 2553, Election by a Small Business Corporation. As a result of the failure of Beneficiary to sign Trust 1's QSST election and Company's S corporation election, Company's S corporation election was ineffective.

Between Date 3 and Date 7, a shares of Company's stock may have been owned by an ineligible S corporation shareholder. Between Date 3 and Date 6 income and other items attributable to the a shares were reported by A, an eligible S corporation shareholder. Beginning Date 6 until Date 7, all income and other items from the a shares were allocated as though H owned b shares and Trust 2 owned c shares. On Date 7, the a shares were transferred b shares to H and c shares to Trust 2. H and Trust 2 were both eligible S corporation shareholders.

Also, between Date 3 and Date 7, d shares of Company's stock may have been owned by an ineligible S corporation shareholder. Between Date 3 and Date 6 income and other items attributable to the d shares were reported by A. Beginning Date 6 until Date 7, all income and other items from the d shares were allocated as though B, C, D, E, F, G, H, J, K, and Trust 1 each owned e shares and Trust 2 owned f shares. On Date 7, the d shares were transferred e shares to B, C, D, E, F, G, H, J, K, and Trust 1, and f shares to Trust 2. B, C, D, E, F, G, H, J, K, Trust 1, and Trust 2 were all eligible S corporation shareholders (other than Trust 1's failure to properly make a QSST election).

Between Date 4 and Date 7, h shares of Company's stock may have been owned by an ineligible S corporation shareholder. Between Date 4 and Date 6 income and other items attributable to the h shares were reported by A. Beginning Date 6 until Date 7, all income and other items from the h shares were allocated as though H owned

i shares and Trust 2 owned k shares. On Date 7, the h shares were transferred i shares to H and k shares to Trust 2.

Also between Date 4 and Date 7, m shares of Company's stock may have been owned by an ineligible S corporation shareholder. Between Date 4 and Date 6 income and other items attributable to the m shares were reported by A. Beginning Date 6 until Date 7, all income and other items from the m shares were allocated as though B, C, D, E, J, K, and Trust 1 each owned n shares, F, G, and H each owned o shares, and Trust 2 owned p shares. On Date 7, the m shares were transferred n shares to B, C, D, E, J, K, and Trust 1, o shares to F, G, and H and p shares to Trust 2.

Between Date 5 and Date 7, r shares of Company's stock may have been owned by an ineligible S corporation shareholder. Between Date 5 and Date 6 income and other items attributable to the r shares were reported by A. Beginning Date 6 until Date 7, all income and other items from the r shares were allocated as though H owned s shares and Trust 2 owned t shares. On Date 7, the r shares were transferred s shares to H and t shares to Trust 2.

Also between Date 5 and Date 7, u shares of Company's stock may have been owned by an ineligible S corporation shareholder. Between Date 5 and Date 6 income and other items attributable to the u shares were reported by A. Beginning Date 6 until Date 7, all income and other items from the u shares were allocated as though B, C, D, E, F, G, H, J, and K each owned v shares, Trust 1 owned w shares, and Trust 2 owned x shares. On Date 7, the u shares were transferred v shares to B, C, D, E, F, G, H, J, and K, w shares to Trust 1, and x shares to Trust 2.

Company represents that there was reasonable cause for the failure of the beneficiary of Trust 1 to sign the consent form for Company's S election and Trust 1's QSST election. Company further represents that these failures were inadvertent oversights and were not motivated by tax avoidance or retroactive tax planning. Company further represents that Company has treated itself consistently with being an S corporation since Date 2 and that the beneficiary of Trust 1 has consistently included his distributive share of Company's income on his federal income tax returns for the year of the invalid election and for all subsequent years as if Trust 1 had timely filed a QSST election. Company further represents that it did not intend for its S corporation election to terminate in connection with the transfers to the potentially ineligible shareholders and any termination was not motivated by tax avoidance. Finally, Company and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of Company as an S corporation.

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 a “small business corporation” as a domestic corporation that is not an ineligible corporation and that 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 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 an S corporation shareholder. Section 1361(c)(2)(B)(i) provides that, in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder for purposes of § 1361(b)(1).

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1362(d)(2) applies.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one 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 beneficiary in the trust shall terminate on the earlier of the 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 that beneficiary; and (B) all of the income (with the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(a)(2) provides that an election under § 1362(a) shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1.1362-6(b)(2)(iv) provides in relevant part that, in the case of a trust described in section 1361(c)(2)(A) (including a trust treated under section 1361(d)(1)(A) as a trust described in section 1361(c)(2)(A)(i)), only the person treated as the shareholder for purposes of section 1361(b)(1) must consent to the election.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made 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 circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is once more 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 any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as continuing to be an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the information submitted and the representations made, we conclude that Company's S election was ineffective because Trust 1 was an ineligible shareholder due to the failure of Trust 1's beneficiary to make a QSST election and to consent on behalf of Trust 1 to Company's S corporation election. In addition, we conclude that the ineffectiveness was inadvertent within the meaning of § 1362(f). If the election had been valid, Company's S corporation status may have terminated on Date 3, Date 4, and Date 5 when Company stock may have been transferred to ineligible shareholders. However, we conclude that, if Company's S corporation election was terminated, such a termination was inadvertent within the meaning of § 1362(f). Consequently, we rule that Company will be treated as continuing to be an S corporation from Date 2 and thereafter, provided that Company's S corporation election is not otherwise terminated under § 1362(d).

A will be treated as the shareholder of the a shares from Date 3 until Date 6, at which point H will be treated as the shareholder of b shares and Trust 2 will be treated as the shareholder of c shares. A will be treated as the shareholder of the d shares from Date 3 until Date 6, at which point B, C, D, E, F, G, H, J, K, and Trust 1 each will be treated as the shareholder of e shares and Trust 2 will be treated as the shareholder of f shares. A will be treated as the shareholder of the h shares from Date 4 until Date 6, at which point H will be treated as the shareholder of i shares and Trust 2 will be treated as the shareholder of k shares. A will be treated as the shareholder of the m shares from Date 4 until Date 6, at which point B, C, D, E, J, K, and Trust 1 each will be treated as the shareholder of n shares, F, G, and H each will be treated as the shareholder of o shares, and Trust 2 will be treated as the shareholder of p shares. A will be treated as the shareholder of the r shares from Date 5 until Date 6, at which point H will be treated as the shareholder of s shares and Trust 2 will be treated as the

shareholder of t shares. A will be treated as the shareholder of the u shares from Date 5 until Date 6, at which point B, C, D, E, F, G, H, J, and K each will be treated as the shareholder of y shares, Trust 1 will be treated as the shareholder of w shares, and Trust 2 will be treated as the shareholder of x shares.

This ruling is conditioned on Trust 1's consent to Company's S corporation election, signed by Beneficiary, being filed with the appropriate service center, indicating that the consent is to be associated with the originally filed Form 2553, within 120 days of this letter. This ruling is further conditioned on Beneficiary of Trust 1 filing a QSST election for Trust 1 with the appropriate service center, effective Date 2, within 120 days of the date of this letter. A copy of this letter should be attached to the consent and to the QSST election. This letter ruling will be null and void if these conditions are not satisfied.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether Company is otherwise eligible to be treated as an S corporation, or whether Trust 1 is eligible to be treated as a QSST.

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.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Laura C. Fields

Laura C. Fields
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter
Copy of this letter for § 6110 purposes

cc: