

Internal Revenue Service

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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
PLR-132106-18

Date:
May 21, 2019

Legend

X =

A =

B =

C =

D =

E =

F =

G =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

State =

Dear _____ :

This letter responds to a letter dated October 24, 2018, submitted on behalf of X, by X's authorized representative, requesting relief from an inadvertent invalid election and termination under § 1362(f) of the Internal Revenue Code (Code).

FACTS

According to the information submitted, X was formed on Date 1 as a corporation under the laws of State. Effective Date 2, X elected to be treated as an S corporation. X's shareholders consented to the S corporation election, including A, but the signature of A's community property spouse, B, was inadvertently omitted from the election. Both A and B represented that at all times since X's S corporation election was filed on Date 2, all items of income, gain, loss, deduction, or credit were reported consistently with such election on all affected federal income tax returns.

In its submission, X represented that it meets the criteria for and requested automatic relief under Rev. Proc. 2004-35 for failing to include B's signature with its S corporation election.

Further, as part of the estate planning for C, D was formed as a grantor trust. E was formed pursuant to the terms of D's trust agreement and became a shareholder of X on Date 3. X represents that because D was a defective grantor trust all items of income, gain, loss, deduction, or credit of X were reported on C's individual tax returns. C died on Date 4.

Subsequent to Date 4, X requested relief under Rev. Proc. 2003-43 for a late filed qualified subchapter S trust (QSST) election for E. The IRS granted the relief on Date 5. Unbeknownst to X, E's governing trust agreement provided for more than one income beneficiary, thereby causing E's QSST election to be invalid. X represents that because E's QSST election was invalid E was an ineligible shareholder of X and caused an inadvertent termination of X's S corporation election on Date 4.

X represents that E, as sole income beneficiary of E, reported E's allocable share of income, gain, loss, deduction, or credit from Date 4 until Date 6. On Date 6, E transferred its X shares to G, a permissible S corporation shareholder.

X represents that the ineffectiveness of its S election and the circumstances resulting in the termination of X's S corporation election were inadvertent and were 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. X and its shareholders 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) of the Code 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 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 the purposes of § 1362(b)(1)(B), a trust all of which is treated (under title 26, subtitle A, chapter 1, subchapter J, part I, subpart E of the United States Code) 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)(1) provides that in the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under § 1361(d)(2), the trust is 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)(3) defines the term "qualified subchapter S trust" as a trust all of the income (within 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. In addition, the terms of the trust must 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 in the trust 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.

Section 1362(a)(1) provides that, except provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(d)(2) provides that a beneficiary of a qualified subchapter S trust (or his legal representative) may elect to have § 1361(d) 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) is 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(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the tax 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 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 event 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 such ineffectiveness or termination, the corporation shall 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 X's S corporation election was invalid because the original S corporation election failed to include the signature of a community property spouse who was a shareholder solely pursuant to state community property law.

Even if X's S election was valid, we conclude that X's S corporation election terminated on Date 4 due to the failure of E being a permissible shareholder under § 1361(d)(3) and that the termination was inadvertent within the meaning of § 1362(f). Accordingly,

X will be treated as continuing to be an S corporation from Date 4 and to Date 6, provided that its S corporation election was otherwise valid and was not otherwise terminated under § 1362(d).

Such relief is conditioned on X filing a request for automatic relief for X's invalid S election effective from Date 2 under Rev. Proc. 2004-35, with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to the request for automatic relief. If X or its shareholders fail to seek automatic relief under Rev. Proc. 2004-35, this ruling is null and void.

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 or implied concerning the eligibility of X to be an S corporation.

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 X's authorized representative.

Sincerely,

Adrienne M. Mikolashek
Branch Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of letter
Copy of letter for § 6110 purposes

cc: