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:B01
PLR-145872-13
Date:
May 05, 2014

Legend

X =

A =

Trust =

Trust A =

Trust B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

Year 2 =

State =

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Dear :

This responds to a letter dated October 31, 2013, and subsequent correspondence, submitted on X's behalf by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation effective Date 1. A established a revocable trust, Trust. Trust was a shareholder of X as of Date 2. On Date 3, A died and Trust continued to qualify as an eligible S corporation shareholder under § 1361(c)(2)(A)(ii). Pursuant to the terms of Trust, shares of X were transferred to Trust A and Trust B on Date 4.

X represents that Trust A was eligible to be a qualified subchapter S trust (QSST) within the meaning of § 1361(d). However, the beneficiary of Trust A did not make an election under § 1361(d)(2) to treat the trust as a QSST. In addition, X represents that Trust B was eligible to be an electing small business trust (ESBT) within the meaning of § 1361(e). However, the trustee of Trust B did not make an election under § 1361(e)(3) to treat the trust as an ESBT. Therefore, Trust A and Trust B were not permissible shareholders and X's S corporation election terminated on Date 4.

X represents that the circumstances resulting in a failure to file QSST and ESBT elections for Trust A and Trust B, respectively, were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X further represents that since Date 4, X, Trust A, and Trust B have filed returns consistent with X having a valid S election. X represents that Trust A has at all times met the requirements of a QSST. X represents that Trust B has at all times met the requirements of an ESBT and that no additional tax is due for Year 1 and Year 2 if Trust B filed its return consistently with it having a valid ESBT election. Lastly, X and its shareholders have agreed to make adjustments, consistent with the treatment of X as an S corporation, as may be required by the Service.

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 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 1 class of stock.

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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 an S corporation shareholder.

Section 1361(c)(2)(A)(ii) and § 1.1361-1(h)(1)(ii) provide that, for purposes of § 1361(b)(1)(B), a trust that is described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death is a permitted S corporation shareholder, but only for the two-year period beginning on the day of the deemed owner's death.

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 section 678(a)) of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Section 1.1361-1(j)(6)(iii) provides that, if S corporation stock is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

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

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (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, 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) 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 during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election was terminated on Date 4 because the beneficiary of Trust A failed to make a timely QSST election and the trustee of Trust B failed to make

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a timely ESBT election. We further conclude that the termination of X's S corporation election was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation on and after Date 4, provided that X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d).

This ruling is contingent on the beneficiary of Trust A filing a QSST election for Trust A and the trustee of Trust B filing an ESBT election for Trust B effective Date 4, with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to the elections.

Accordingly, X's shareholders, in determining their respective income tax liabilities, must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account distributions made by X as provided by § 1368.

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 on whether X was or is otherwise eligible to be treated as an S corporation or whether Trust A meets the requirements of a QSST or whether Trust B meets the requirements of an 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 the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Joy C. Spies
Joy C. Spies
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
Passthroughs and Special Industries

Enclosures (2)
Copy of this letter
Copy of this letter for § 6110 purposes

cc:

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