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-121133-14

Date:
November 24, 2014

LEGEND

X =

A =

B =

C =

Trust =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Year =

State =

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Dear :

This responds to a letter dated May 7, 2014, and subsequent information, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code). A ruling is also requested that (1) each share qualifies as a separate share under § 663(c) and (2) each share qualifies as a QSST within the meaning of § 1362(d)(3).

FACTS

According to the information submitted and representations within, X was incorporated on Date1, under the laws of State. Trust, a grantor trust, became a shareholder of X on Date2. Effective Date3, X elected to be treated as an S corporation. On Date4, A, the grantor of Trust, died. On Date5, Trust became an ineligible shareholder of X, causing X's S election to terminate on Date5.

Under the terms of Trust, upon A's death, the trustee is to distribute a specific dollar amount of net income to the children of B. Trust further provides that, after making any payments to the children of B, Trust's property and income shall be divided into two shares. The income from one share is required to be paid to B and the income from the other share is required to be paid to C. During the life of B and C (the income beneficiaries) the income and principal from one beneficiary's share can only be paid to that income beneficiary. Neither income beneficiary has a claim against the income and principal of the other beneficiary's share. Neither beneficiary has affirmatively refused to consent to the QSST election to be effective Date5. Upon the death of both B and C, the corpus of Trust as well as any undistributed income shall be paid equally to the children of B.

As of Date5, X represents that Trust was intended to be treated as a Qualified Subchapter S Trust (QSST), however, B, the current beneficiary of Trust, did not timely file a QSST election with respect to Trust, resulting in X's S corporation election terminating effective Date5. X represents that the failure to timely file a QSST election was discovered by X's tax advisor in Year.

X represents that its S corporation termination was inadvertent and not motivated by tax avoidance or retroactive tax planning. X also represents that B's and C's failure to file a timely QSST election was unintentional and was not motivated by tax avoidance or retroactive tax planning. Further, X represents that X and its shareholders agree to make any adjustments required by the Secretary.

X also represents that all income has been reported on all affected returns of X and all of its shareholders consistent with the treatment of X as an S corporation, and that

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neither X nor any of its shareholders intended to terminate X's S election. In addition, X represents that Trust has qualified as a QSST under § 1361(d) at all times since Date5 and, other than the inadvertent termination due to an ineligible shareholder, X has qualified as a small business corporation at all times since its S election on Date3.

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 1 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.

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 beneficiary of such trust shall be treated as the owner (for purposes of § 678(a)) of that portion of the QSST which consists of stock in an S corporation to which the election under § 1361(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term "qualified subchapter S trust" means 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 that beneficiary; and (B) all of the income (within the meaning of § 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 a trust within the meaning of § 663(c) shall be treated as a separate trust for purposes of § 1361(c) and (d).

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Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such 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 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); (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 such ineffectiveness, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the election was made or 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 ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(j)(3) provides that for purposes of sections 1361(c) and (d), a substantially separate and independent share of a trust, within the meaning of section 663(c) and the regulations thereunder, is treated as a separate trust. For a separate share which holds S corporation stock to qualify as a QSST, the terms of the trust applicable to that separate share must meet the QSST requirements stated in paragraphs (j)(1)(i) and (ii) of section 1.1361-1.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations, provides that the current income beneficiary of the trust must make the QSST election by signing and filing with the service center with which the corporation files its income tax the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(j)(6)(iii)(A) 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 1.1361-1(j)(7)(i) provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

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Section 663(c) provides that for the sole purpose of determining the amount of distributable net income in the application of §§ 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts, including the application of subpart D, shall be determined in accordance with regulations prescribed by the Secretary.

Section 1.663(c)-1(a) provides that if a single trust has more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts for the sole purpose of determining the amount of distributable net income allocable to the respective beneficiaries under §§ 661 and 662 (the separate share rule). The regulations further provide, in § 1.663(c)-1(c), that the separate share rule may be applicable even though separate and independent accounts are not maintained and are not required to be maintained for each share on the books of account of the trust, and even though no physical segregation of assets is made or required.

Section 1.663(c)-3(a) provides that the applicability of the separate share rule generally depends on whether trust distributions are to be made in substantially the same manner as if separate trusts had been created. In determining whether separate shares exist, it is immaterial whether the principal and any accumulated income of each share is ultimately distributable to the beneficiary of such share, to the beneficiary's descendants, appointees under a general or special power of appointment, or to any other beneficiaries (including a charitable organization) designated to receive the beneficiary's share of the trust and accumulated income upon termination of the beneficiary's interest in the share. Thus, a separate share may exist if the instrument provides that upon the death of the beneficiary of the share, the share will be added to the shares of the other beneficiaries of the trust.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date5. We further conclude that the termination of X's S election on Date5 was inadvertent within the meaning of § 1362(f).

In addition, we conclude that the shares of Trust created upon the death of A are substantially separate and independent shares within the meaning of § 663(c) and, therefore, that each share is treated as a separate trust for purposes of § 1361(d).

We further conclude that provided that all the net income (within the meaning of § 643(b)) for each share is distributed currently to the applicable income beneficiary and

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each share is administered as a QSST, each share of Trust will qualify as a QSST under § 1361(d)(3) during the life of the income beneficiary for that share.

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation as of Date5 and thereafter, provided that B and C each file a QSST election for their respective share, with an effective date of Date5, with the appropriate service center within 120 days from the date of this letter, and provided that X's S corporation election is not otherwise terminated under § 1362(d). A copy of this letter must be attached to the QSST elections.

Except as specifically ruled upon above, we express or imply no opinion concerning the 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 whether Trust was otherwise a valid 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, a copy of this letter will be sent to X's authorized representative.

Sincerely,

Joy C. Spies
Joy C. Spies
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 section 6110 purposes

cc:

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