Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:03
PLR-130029-10

Date:
October 14, 2010

Company =

State =

Date 1 =

Trust 1 =

Trust 2 =

A =

B =

Dear :

This responds to a letter dated July 13, 2010, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

Company is incorporated in State, and the Service accepted its election to be treated as an S corporation with an effective date of Date 1. Company has 100 shares of Class A voting common stock outstanding, and 1,400 shares of Class B non-voting stock outstanding, both of which Company represents confers identical rights to distribution and liquidation proceeds. Trust 1, a grantor trust wholly owned by A under

subpart E of part I of subchapter J of chapter 1 of the Code ("Subpart E"), owns the 100 shares of Class A voting common stock, and Trust 2, which is not a grantor trust and whose current income beneficiary is B, owns the 1,400 shares of Class B non-voting stock. Company's shareholders were the same at the time it made its S corporation election and at all relevant times since then. Company represents that A and B signed the Company's Form 2553, Election by a Small Business Corporation, consenting to the S corporation election. As none of the Company's accountant, or either of the trustees of Trust 1 or Trust 2, were aware that a qualified subchapter S trust ("QSST") election was necessary to qualify Trust 2 as a shareholder of an S corporation, through inadvertence, no such election was made. As such, Trust 2 was an ineligible shareholder and Company's S corporation election was never valid.

Company represents that there was no intent to make an invalid S corporation election and the invalid election was not motivated by tax avoidance or retroactive tax planning. For all taxable years, Company and Company's shareholders have filed Federal tax returns consistent with Company qualifying as an S corporation. In addition, Company and Company's shareholders agree to make any adjustments consistent with the treatment of Company 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(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not 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.

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) as owned by an individual who is a citizen or resident of the United States, may be a shareholder.

Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1) in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

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), and (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.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply.

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 1362(f) provides that (1) If an election under § 1362(a) or § 1361(b)(3)(B)(ii) 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) or to obtain shareholder consents, or was terminated under paragraph (2) or (3) of § 1362(d) or § 1361(b)(3)(C); (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 or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or (B) to acquire the required shareholder consents, 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 or a qualified subchapter S subsidiary, as the case may be) 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 or a qualified subchapter S subsidiary, as the case may be during the period specified by the Secretary.

Section 1.1361-1(h)(1)(iii) provides that in general, a trust is not a permitted small business corporation shareholder. However, except as provided in § 1.1361-1(h)(2), QSST that has a § 1361(d)(2) election in effect (an electing QSST), is a permitted shareholder.

Section 1.1361-1(j)(6)(ii) 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 return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1362-4(b) provides that for purposes of § 1.1362-4(a), the determination of whether a termination or invalid 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 termination or invalid election was inadvertent. The fact that the terminating event or invalidity of the election was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination or invalidity of the election was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation or QSub during the period specified by the Commissioner. In the case of stock held by an ineligible shareholder that causes an inadvertent termination or invalid election for an S corporation under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of the S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent the loss of any revenue due to the holding of stock by an ineligible shareholder (for example, a nonresident alien).

Section 1.1362-6(b)(1) provides that except as provided in § 1.1362-6(b)(3)(iii), the election of the corporation is not valid if any required consent is not filed in accordance with the rules contained in § 1.1362-6.

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

CONCLUSION

Based solely upon the representations made and the information submitted, we conclude that Company's S corporation election was not effective on Date1, due to Trust 2 being an ineligible shareholder. We further conclude that the circumstances resulting in such ineffectiveness were inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), Company will be treated as an S corporation on and after Date1, unless Company's S corporation election is otherwise terminated under § 1362(d), provided that the following conditions are met.

Within one hundred twenty (120) days of the date of this letter, B, the beneficiary of Trust 2 must file a QSST election effective Date1 with the appropriate service center. A copy of this letter should be attached to the QSST election.

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 as to whether Company otherwise meets the requirements to be an S corporation or whether (i) Trust 2 satisfies the requirements to be an QSST, (ii) Trust 1 is a grantor trust, or (iii) Company's S corporation election was otherwise valid and not otherwise terminated under § 1362(d).

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.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Company's authorized representative.

Sincerely,

/s/

James A. Quinn
Senior Counsel
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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