

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
, ID No.

Telephone Number:

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PLR-126177-13  
Date: 08/13/2013

Legend

X =

Trust =

A =

State =

Date 1 =

Date 2 =

Date 3 =

Dear :

This responds to a letter, submitted June 10, 2013 on behalf of X by its authorized representatives, requesting a ruling under section 1362(f) of the Internal Revenue Code.

FACTS

Based on the materials submitted, we understand the relevant facts to be as follows. X was incorporated under the laws of State. X elected to be treated as an S corporation effective Date 1. The Trust was created under A's will, effective Date 2.

On Date 2, shares of X were transferred to Trust from the A's estate with the intention that Trust be treated as a Qualified Subchapter S Trust (QSST). For all related purposes, X represents that Trust otherwise was an eligible shareholder under Section 1361(c)(2)(A)(iii) during the required two-year filing period of Date 2 through Date 3.

Following the acquisition of X's stock by Trust, the beneficiary of Trust failed to file a QSST election within the required 2-year period, causing Trust to be an ineligible shareholder. X's S election was therefore terminated on Date 3.

X states that neither it nor its shareholders intended to terminate the S corporation status as a result of the transfer of stock to Trust. It also represents that the circumstances causing the termination of its section 1362(a) election were inadvertent and not the result of retroactive tax planning or tax avoidance. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

#### LAW

Section 1361(a) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

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

Section 1361(b)(1) provides that the term "small business corporation" means 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 section 1361(c)(2), or an organization described in section 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)(iii) states that for purposes of subsection (b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which such stock is transferred to it, may qualify as a shareholder.

Section 1361(d)(1) provides, in general, that in the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under paragraph (2), (A)

such trust shall be treated as a trust described in subsection (c)(2)(A)(i), (B) for purposes of section 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 paragraph (2) is made, and (C) for purposes of applying section 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust shall be treated as a disposition by such beneficiary.

Section 1361(d)(3) provides that 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, (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 such beneficiary, and (B) all of the income (within the meaning of section 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.

Section 1362(d)(2)(A) provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the 1<sup>st</sup> day of the 1<sup>st</sup> taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under section 1362(a) or 1361(b)(3)(B)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or (B) was terminated under section 1362(d)(2), section 1362(d)(3), or section 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 this subsection, 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 1.1362-4(b) of the Income Tax Regulations provides that, for purposes of section 1.1362-4(a), the determination of whether a termination 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 event 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 during the period specified by the Commissioner.

### CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's election to be treated as an S corporation was terminated Date 3 because the beneficiary of Trust did not make a timely QSST election.

The acquisition of X's shares by Trust was done under the assumption Trust qualified as a shareholder, but due to the failure to file a QSST election, Trust's eligibility expired on Date 3. X and its shareholders represent that the transaction was not motivated by retroactive tax planning nor by tax avoidance and the Taxpayer and shareholders are willing to make any adjustments as may be required. We hold that the termination of the Taxpayer's S corporation election was inadvertent within the meaning of section 1362(f). Pursuant to section 1362(f), the Taxpayer will continue to be treated as an S corporation from Date 3 and thereafter, provided that the Taxpayer's S corporation election is not otherwise terminated under section 1362(d).

Accordingly, X's shareholders, in determining their federal tax liability, must include their pro rata share of the separately and non-separately computed items of X under section 1366, make any adjustments to stock basis under section 1367, and take into account any distributions made by X to shareholders under section 1368. This ruling shall be null and void if the requirements of this paragraph are not met.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the above-described facts under any other provision of the Code. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

Sincerely,

*Laura Fields*

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

Enclosures (2):

Copy of this letter

Copy for § 6110 purposes