

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201537001**

Release Date: 9/11/2015

Index Numbers: 1362.00-00, 1362.01-00,
1362.04-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-103314-15

Date:
May 20, 2015

LEGEND

X =

Y =

Trust 1 =

Trust 2 =

A =

B =

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Year =

Dear :

This responds to a letter dated December 30, 2014, and subsequent correspondence on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that Y incorporated in State 1 on Date 1. X incorporated in State 2 on Date 2. X represents that the shareholders of Y exchanged their shares in Y for the shares of X in a tax-free exchange. X made an election to be treated as an S corporation effective Date 3. Also effective Date 3, X elected to treat Y as a qualified subchapter S subsidiary (QSub). However, Trust 1, one of X's shareholders, failed to consent properly to X's S corporation election. The trustee of Trust 1, a trust the separate shares of which each qualified as an eligible shareholder under § 1361(c)(2)(A)(i), and not A and B, the owners of the separate shares of Trust 1, executed X's Form 2553, Election by a Small Business Corporation, on behalf of Trust 1. Therefore, Trust 1 did not consent properly to X's S corporation election. Accordingly, X's S corporation election and Y's QSub election were ineffective. On Date 4, Trust 1 sold a portion of its X stock to an individual. On Date 5, Trust 1 distributed the rest of its X stock to A.

In addition, Trust 2 was a shareholder of X on Date 3. X represents that Trust 2 was eligible to be an electing small business trust (ESBT) within the meaning of § 1361(e) effective Date 3. However, no election to be an ESBT was filed on behalf of Trust 2. Therefore, Trust 2 was not a permissible shareholder and X's S corporation election and Y's QSub election, had they been valid on Date 3, were ineffective. In Year, Trust 2 transferred its shares of X stock to individual beneficiaries.

X represents that the circumstances resulting in X's invalid S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X further represents that for all taxable years, it has filed returns consistent with treating X as an S corporation and Y as a QSub. In addition, X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

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)(B) provides that the term “small business corporation” means a domestic corporation that is not an ineligible corporation and that does not, among other requirements, 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 of part I of subchapter J of chapter 1 of the Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(A)(v) provides that an ESBT, within the meaning of § 1361(e)(1), may be a shareholder for purposes of § 1361(b)(1)(B). The trustee of the trust makes the ESBT election pursuant to § 1361(e)(3). Section 1.1361-1(m)(2)(i) provides that the trustee of an ESBT must make the election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1362(f) provides that if (1) 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; (2) the Secretary determines that the circumstances resulting in such ineffectiveness 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 election was made is a small business corporation or a QSub, as the case may be, or to acquire the required shareholder consents; and (4) the corporation for which the election was made, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agree to make the adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's S corporation election and Y's QSub election were ineffective on Date 3 as a result of the improper consent to X's S corporation election and because Trust 2 was an ineligible shareholder. We further conclude that the ineffectiveness of X's S corporation election and Y's QSub election constituted inadvertent invalid elections within the meaning of § 1362(f). Consequently, under § 1362(f), X will be treated as an S corporation from Date 3 and thereafter provided that X's S corporation election was otherwise valid and

not otherwise terminated under § 1362(d). Furthermore, Y will be treated as a QSub of X from Date 3 and thereafter, provided that Y's QSub election was otherwise valid and not otherwise terminated.

This ruling is contingent on X and its shareholders filing their federal income tax returns consistent with X being an S corporation. This ruling is also contingent on A and B signing a written statement as described in § 1.1362-6(b)(1) consenting to X's S corporation election effective Date 3. The written statement must be filed with the appropriate service center within 120 days from the date of this letter, indicating that the statement is to be associated with X's originally filed Form 2553.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion on whether X was or is otherwise eligible to be treated as an S corporation or whether Y was or is otherwise eligible to be treated as a QSub.

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

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

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 ruling request, it is subject to verification on examination.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes