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:

Telephone Number:

Refer Reply To:
CC:PSI:B01
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Date:
August 10, 2015

LEGEND:

X =

GRAT 1 =

GRAT 2 =

GRAT 3 =

Trust 1 =

Trust 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Dear

This responds to a letter dated January 30, 2015, submitted on behalf of X by its authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on Date 1. Effective Date 2, X elected to be taxed as an S corporation. On Date 3, shares of X stock were transferred to GRAT 1. On Date 4, shares of X stock were transferred to GRAT 2 and GRAT 3. At the time of the transfer GRAT 1, GRAT 2, and GRAT 3 were treated as grantor trusts under subpart E of part I of subchapter J of chapter 1 of the Code.

On Date 5, the shares of X stock held by GRAT 1 were transferred to both Trust 1 and Trust 2, established as successor trusts. Trust 1 and Trust 2 were intended to be treated as grantor trusts from Date 5 until Date 6. However, Trust 1 and Trust 2 did not qualify as grantor trusts during this period. Trust 1 and Trust 2 met the requirements to be Electing Small Business Trusts (ESBTs), within the meaning of § 1361(e), and ESBT elections were made for them as of Date 6. Consequently, Trust 1 and Trust 2 were ineligible shareholders from Date 5 until Date 6, and, as a result, X's S corporation election terminated on Date 5.

On Date 7, GRAT 2 and GRAT 3 ceased to be grantor trusts and eligible S corporation shareholders; however, GRAT 2 and GRAT 3 continued to hold shares of X until Date 8 at which point the shares were transferred to eligible S corporation shareholders. Therefore, X's S corporation election would have terminated on Date 7 (if it had not already terminated on Date 5) when GRAT 2 and GRAT 3 ceased to be eligible S corporation shareholders.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X and its shareholders have filed their federal

income tax returns consistent with having a valid S corporation election in effect for X. X and its shareholders have agreed to make any adjustments consistent with the treatment of X 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(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.

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 Internal Revenue 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, for purposes of § 1361(b)(1)(B), an ESBT may be an S corporation shareholder.

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 the termination, steps were taken so that the corporation is a small business corporation; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representations made, we conclude X's S election terminated on Date 5 when shares of X were transferred to Trust 1 and Trust 2. We further conclude that the termination was inadvertent within the meaning of § 1362(f). Moreover, had X's S corporation not already terminated, it would have

terminated on Date 7 when GRAT 2 and GRAT 3 became ineligible shareholders. Similarly, this terminating event would have been an inadvertent termination within the meaning of § 1362(f).

Accordingly, under § 1362(f), X will be treated as continuing to be an S corporation from Date 5 and thereafter, provided that X's S election is valid and not otherwise terminated under § 1362(d).

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be 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 the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

Faith P. Colson
Faith P. Colson
Senior Counsel, Branch 1
(Passthroughs & Special Industries)

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

cc: