

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B03  
PLR-123788-16  
Date:  
November 28, 2016

X =

Date 1 =

Date 2 =

A =

Date 3 =

Date 4 =

Family Trust =

Trust 1 =

Trust 2 =

Dear \_\_\_\_\_ :

This responds to a letter dated July 28, 2016 submitted on behalf of X by X's authorized representative, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

## FACTS

According to the information submitted and representations made, X was incorporated on Date 1. Effective Date 2, X elected to be taxed as an S corporation under § 1362 of the Code. Prior to Date 3, Trust was a grantor trust wholly owned by A and was an eligible shareholder of X. On Date 3, A died and Trust ceased being a grantor trust. Upon A's death, the shares of X held by Trust were transferred to Trust 1 and Trust 2. Trust 1 and Trust 2 qualified under § 1361(c)(2)(A)(ii) as an eligible shareholders for two years from A's date of death. However, timely elections to treat Trust 1 and Trust 2 as qualified subchapter s trusts ("QSST") after this period was not made. Trust 1 and Trust 2 became an ineligible shareholders of X, causing X's S corporation election to terminate, effective Date 4.

X represents that since Date 2, it has filed its federal income tax returns consistent with being an S corporation. X represents that its S corporation election termination was inadvertent and was not motivated by tax avoidance or retroactive tax planning. Trust 1, Trust 2, and X represent that Trust 1 and Trust 2 would have qualified as QSSTs since Date 4 and that they have filed returns consistent with this treatment. Further, X represents that X and its shareholders will make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) of the Code that may be required by the Secretary.

## 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(c)(2)(A) provides, in relevant part, that, for purposes of § 1361(b)(1)(B), the following trusts may be shareholders of an S corporation: (i) 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; (ii) a trust that was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death; and (iii) a trust to which stock has been transferred by a will, but only for the 2-year period beginning on the day of the owner's death.

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), (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 paragraph (2) is

made, and (C) for purposes of applying §§ 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)(2) provides that a beneficiary of a qualified subchapter S trust (or his legal representative) may elect to have § 1361(d)(1) apply. An election under § 1362(d)(2) shall be made separately with respect to each corporation the stock of which is held by the trust.

Section 1361(d)(3) defines “qualified subchapter S trust” as 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 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 1.1361-1(m)(2)(iii) provides that the election must be filed within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a qualified subchapter S trust election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the first day of the first 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) or § 1361(b)(3)(B)(ii) 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 such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which 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 the 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 termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election inadvertently terminated within the meaning of § 1362(f) on Date 4 due to the trustee's failure to make QSST elections for Trust 1 and Trust 2. Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 4 and Trust 1 and Trust 2 will be treated as QSSTs from Date 4.

This ruling is contingent upon, within 120 days from the date of this letter, the trustee filing with the appropriate service center elections to treat Trust 1 and Trust 2 as QSSTs effective as of Date 4. A copy of this letter should be attached to the QSST elections.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal 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 Trust 1 and Trust 2's eligibility to be QSSTs. Furthermore, no opinion is expressed or implied as to the federal income tax consequences of the transfer of X shares from Trust to Trust 1 and Trust 2.

This ruling is directed only to the taxpayer that 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, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Richard T. Probst  
Senior Technician Reviewer, Branch 3  
Associate Chief Counsel  
(Passthroughs and Special Industries)

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

cc: