

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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Date:
June 19, 2017

Legend

X =

A =

Trust =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Dear :

This responds to a letter dated January 12, 2017, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted, X was incorporated under the laws of State on Date1. X elected to be treated as an S corporation effective Date2. On Date3, stock in X was transferred to Trust. A, the trustee of Trust, and X intended to treat and have

always treated Trust as an Electing Small Business Trust (ESBT). However, an election to treat Trust as a Qualified Subchapter S Trust (QSST) effective Date4 was inadvertently filed on Date5. Trust did not act as a QSST. Consequently, Trust was an ineligible shareholder, and, as a result, X's S corporation election terminated on Date3.

X represents that the circumstances resulting in the termination of its S corporation election were inadvertent and not motivated by tax avoidance or retroactive tax planning. Additionally, X and its shareholders have filed their federal income tax returns consistent with having a valid S corporation election in effect. X and its shareholders have agreed to make any adjustment 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) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

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 § 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 one 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) 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 § 1362(b)(1)(B), an ESBT is a permitted shareholder of a small business corporation.

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), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, 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 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) 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 (B) was terminated under §

1362(d)(2) or (3); (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 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 pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

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. 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).

CONCLUSION

Based solely on the information submitted and the representations made, we conclude that X's S election terminated on Date3 when Trust became a shareholder, and that the termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation from Date3, and thereafter, provided that X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d).

This ruling is contingent upon X and all of its shareholders treated X as having been and S corporation, and Trust as having been an ESBT, for the period beginning Date3, and thereafter. Within 120 days from the date of this letter, the trustee of Trust must file an election to treat Trust as an ESBT, effective Date3, with the appropriate service center. A copy of this letter should be attached to the election. If these conditions are not met, then this ruling is null and void.

Accordingly, X's shareholders, in determining their respective income tax liabilities, must include their pro rata share of the separately and non-separately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account distributions made by X as provided by § 1368.

Except as expressly provided herein, no opinion is express or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in

this letter. Specifically, no opinion is express concerning whether X is otherwise eligible to be treated as an S corporation or whether Trust is eligible to be treated as an ESBT.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling 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 your authorized representative.

Sincerely,

Laura C. Fields

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

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