

Internal Revenue Service

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Department of the Treasury
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Third Party Communication: None
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Person To Contact:

Telephone Number:

Refer Reply To:
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Date:
April 24, 2018

LEGEND:

X =

A =

B =

C =

Trust 1 =

Trust 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Dear

This responds to a letter dated October 24, 2017, and subsequent information, submitted on behalf of X, requesting inadvertent termination relief pursuant to § 1362(f) of the Internal Revenue Code (the Code).

Facts

The information submitted states that X was formed under the laws of State on Date 1. X filed a timely election under § 1362(a) to be taxed as an S corporation effective Date 2. A was a shareholder of X. On Date 3, A transferred shares of X stock to Trust 1. Trust 1 was treated (under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code) as owned by A. Thus, as of Date 2 Trust was a permitted S corporation shareholder pursuant to § 1361(c)(2)(A)(i). On Date 4, A died and Trust ceased to qualify as a shareholder under § 1361(c)(2)(A)(i). Trust continued to qualify as an eligible S corporation shareholder under § 1361(c)(2)(A)(ii) for the 2-year period beginning on the date of A's (the deemed owner) death. Pursuant to the terms of Trust 1, after A's death, the trustee of Trust 1 established Trust 2. Shares of X stock were transferred to Trust 2 on Date 5.

X represents that Trust 2 at all times qualified to elect to be a Qualified Subchapter S Trust (QSST) within the meaning of § 1361(d)(3); however, B, the initial current income beneficiary of Trust 2, failed to timely file a QSST election for Trust 2. Therefore, Trust 2 was an ineligible shareholder of X and X's S corporation election terminated effective Date 5.

On Date 6, B died and under the terms of Trust 2, C became the current income beneficiary of Trust 2. Had B timely made the QSST election, then C, the remainder income beneficiary of Trust 2, would have been considered a successive income beneficiary under § 1361(d)(2)(B)(ii) of the Code such that C would not be required to file a new QSST election for Trust 2.

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) 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(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 the purposes of § 1362(b)(1)(B), a trust all of which is treated (under title 26, subtitle A, chapter 1, subchapter J, part I, subpart E of the United States Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation.

Section 1361(c)(2)(A)(ii) provides that a trust which was described in 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed 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), the trust is 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 1361(d)(2)(B)(ii) provides that if a QSST election is made with respect to any beneficiary, an election under this paragraph shall be treated as made by each successive beneficiary unless such beneficiary affirmatively refuses to consent to such election.

Section 1361(d)(3) defines the term “qualified subchapter S trust” as a trust all of the income (within the meaning of 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States. In addition, the terms of the trust must require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary in the trust 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.

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

Section 1362(d)(2)(A) provides that an election under § 1362(a) is 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(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the tax 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, or (B) was terminated under paragraph (2) or (3) of § 1362(d); (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 event resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, 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.

Conclusion

Based solely on the facts submitted and representations made, we conclude X's S election terminated on Date 5 resulting from the failure of B, as the current income beneficiary of Trust 2, to make the election under § 1361(d)(2).

We further conclude that the termination was inadvertent within the meaning of § 1362(f). Accordingly, X will be treated as continuing to be an S corporation from Date 5 and thereafter, provided that its S corporation election was otherwise valid and was not otherwise terminated under § 1362(d). Trust 2 will be treated as a QSST from Date 5 and thereafter, provided that C files a QSST election effective Date 5 with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached the QSST election.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning the eligibility of X to be an S corporation.

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.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

Sincerely,

Laura C. Fields

Laura C. Fields
Senior Technician Reviewer, Branch 1
(Passthroughs & Special Industries)

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