

This letter responds to a letter dated October 1, 2019, and subsequent correspondence, submitted on behalf of X from X's authorized representative, requesting inadvertent termination relief pursuant to § 1362(f) of the Internal Revenue Code (the Code).

FACTS

The information submitted states that X was incorporated under the laws of State on Date 1 and elected to be an S corporation effective Date 2. On Date 2, Trust 1 owned shares of X stock. X represents that Trust 1 was treated under subpart E of part I of subchapter J of chapter 1 of the Code as entirely owned by A and, thus, an eligible shareholder under § 1361(c)(2)(A)(i). On Date 3, A died. Under § 1361(c)(2)(A)(ii), Trust 1 remained an eligible shareholder until the trustees of Trust 1 transferred Trust 1's shares of X stock to Trust 2 on Date 4. X represents that Trust 2 satisfied the qualified subchapter S trust (QSST) requirements under § 1361(d)(3). However, B, Trust 2's income beneficiary, failed to make an election under § 1361(d)(2) to treat Trust 2 as a QSST effective Date 4. Therefore, X's S corporation election terminated on Date 4.

X represents that the failure to file a QSST election was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X represents that B reported Trust 2's allocable share of X's income (or loss) consistent with the treatment of Trust 2 as a QSST on all affected returns. Finally, 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) 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 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 of an S corporation.

Section 1361(c)(2)(A)(ii) provides that for purposes of § 1361(b)(1)(B), 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 may be a shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(d)(3) defines a QSST as a trust, (A) the terms of which 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 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 one individual who is a citizen or resident of the United States.

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) and, (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 § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing, with the service center with which the S corporation files its income tax return, the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall 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) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (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 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 the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then,

notwithstanding the circumstances resulting in the termination, the corporation will 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 that X's S corporation election terminated on Date 4 when Trust 2 became an ineligible shareholder. We further conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 4 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d).

This ruling is contingent on B filing a QSST election for Trust 2 effective Date 4, with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to the QSST election.

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 2's eligibility to be a QSST.

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.

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.

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

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: