

Internal Revenue Service

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, ID No.

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Date:

October 18, 2019

LEGEND

X =

Y =

A =

B =

C =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

Trust5 =

Trust6 =

State1 =

State2 =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

Date9 =

Date10 =

Date11 =

Date12 =

Date13 =

Date14 =

Date15 =

Date16 =

Date17 =

Date18 =

N1 =

N2 =

N3 =

N4 =

N5 =

N6 =

N7 =

N8 =

N9 =

N10 =

Dear :

This responds to a letter dated April 11, 2019, submitted on behalf of X by the authorized representatives of X, requesting a ruling under §1362(f) of the Internal Revenue Code ("Code").

FACTS

The information submitted states that X was formed as a limited liability company under the laws of State1 on Date1 and elected to be an S corporation effective on Date1. At the time of X's formation, X was owned equally by A and B. On Date2, A assigned A's ownership interest to A's wholly-owned limited liability company, Y, which was formed under the laws of State2 on Date3 and treated as disregarded as an entity separate from A for federal tax purposes. On Date4, B assigned a N1% interest in X to Trust1. Trust1 has always been treated as a grantor trust of B.

On Date5, A made a gift of a N2% interest in Y to Trust2. Prior to this gift, Trust2 was treated as a grantor trust of C (A's spouse). As a result of this gift, under the terms of the trust agreement for Trust2, the portion of Trust2 that held an interest in Y was treated as a grantor trust of A. Accordingly, after this transfer, A directly held a N3% ownership interest in Y and indirectly held a N2% interest in Y through A's portion of Trust2. On Date6, A made a gift of a N4% ownership interest in Y to Trust3. Under the terms of the trust agreement for Trust3, Trust3 was treated as a grantor trust of A. On Date7, A died unexpectedly.

According to the submission, prior to A's death, Trust3 and the portion of Trust2 treated as owned by A were both properly treated as grantor trusts owned by A. Therefore, Y was properly treated as a disregarded entity and was an eligible S corporation shareholder of X. However, as a result of A's death on Date7, Trust3 and A's portion of Trust2 were no longer treated as grantor trusts owned by A, and therefore Y was no longer treated as having a single owner. As a result, Y began to be treated as a partnership for federal income tax purposes under § 301-7701-3(f)(2) of the Income Tax Regulations and was no longer an eligible S corporation shareholder of X.

On Date8, the portion of Trust2 that had been treated as a grantor trust owned by A distributed its interest in Y to the children of A in equal shares. On Date9, pursuant to A's will, A's remaining N5% direct ownership interest in Y that A held at the time of A's death was distributed by A's estate to Trust4 and Trust5 with Trust4 receiving a N6% ownership interest in Y and Trust5 receiving a N7% ownership interest in Y. On Date10, Trust5 filed a Qualified Subchapter S Trust ("QSST") election, effective Date9, with respect to another S corporation in which it held stock (but not with respect to X or Y). On Date11, Trust4 filed an Electing Small Business Trust ("ESBT") election effective as of Date9.

On Date12, Trust5 distributed a N8% ownership interest in Y to its beneficiary, C. On Date13, C transferred partially by gift and partially by sale the N8% ownership interest in Y to the portion of Trust2 treated as a grantor trust owned by C. A N9% ownership interest in Y was subsequently re-allocated from Trust2 to Trust6 effective Date13. According to the submission, Trust6 is also treated as a grantor trust owned by C. On Date14, Trust3 was merged into the portion of Trust2 treated as a grantor trust owned by C, pursuant to a power accorded the trustee under the trust agreement of Trust3. According to the submission, the portion of Trust2 treated as owned by C was properly treated as a grantor trust both before and after this merger. On Date15, Trust5 distributed its N10% ownership interest in Y to its beneficiary, C. On Date16, C sold this N10% interest to the portion of Trust2 treated as a grantor trust owned by C.

On Date17, after the discovery that Y was an ineligible S corporation shareholder of X, on the advice of counsel Y sought relief under Rev. Proc. 2013-40, 2013-36 I.R.B. 173, to make a late entity classification election to be treated as an association taxable as a corporation, and to make a late S corporation election, with both elections effective

on Date18 (the day after A's death). Both of these late elections were accepted by the Internal Revenue Service. However, as a result of these elections, Y remained an ineligible S corporation shareholder of X. Nevertheless, as part of the process for requesting relief under Rev. Proc. 2013-40, Trust3 and the portion of Trust2 treated as a grantor trust owned by A made ESBT elections effective on Date18.

X represents that from the date of A's death to the present, all of the owners of Y are eligible S corporation shareholders. X further represents X and X's shareholders have always filed tax returns consistent with X being an S corporation. X further 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. X and each person who was a direct or indirect shareholder of X at any time since Date7 agree to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

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)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not 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.

Section 1361(d)(1) provides, in pertinent part, that a QSST whose beneficiary makes an election under § 1362(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1361(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), the election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term "qualified subchapter S trust" means 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 termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) 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.

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 by signing and filing with the service center with which the 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(a)(1) 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(d)(2) 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. A termination of an S corporation election under § 1362(d)(2) is effective on or after the date of cessation.

Section 1362(f) provides, in pertinent part, 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 the representations made, we conclude that X's S corporation election terminated on Date7 resulting from Y becoming an ineligible S corporation shareholder of X upon A's death. In addition, we conclude that X's S corporation election would have terminated on Date9 as a result of the failure by C to properly and timely file a QSST election on behalf of Trust5 with respect to X (where Trust5 is properly treated as a shareholder of X rather than Y on Date9) if the S corporation election had not previously terminated on Date7. We conclude that these terminating events were inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on Date7 and thereafter, unless X's S corporation election otherwise terminated under § 1362(d).

This ruling is contingent on Y distributing its ownership interests in X to Y's current owners within 120 days of the date of this letter. This ruling is also contingent upon C filing QSST elections on behalf of Trust5 with respect to X and Y with an effective date of Date9, within 120 days of the date of this letter. Copies of this letter should be attached to the QSST elections. If either of these conditions is not met, then this letter ruling is null and void. Furthermore, if either of these conditions is not met, X must send a notification that its S corporation election has terminated as of Date7 to the service center with which X's S corporation election was filed.

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 regarding X's eligibility to be an S corporation or the validity of its S corporation election. In addition, no opinion is expressed or implied regarding whether the current owners of Y who will receive ownership interests in X from Y are eligible S corporation shareholders. Further, no opinion is expressed or implied as to whether Trust5 qualifies as a QSST.

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 request for a ruling, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

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

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

cc: