

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-110068-11
Date:
September 06, 2011

Legend

X =

Trust =

A =

B =

State =

D1 =

D2 =

D3 =

D4 =

Dear :

This letter responds to a letter dated February 15, 2011, and subsequent correspondence submitted on behalf of X and B by their authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on D1. A Form 2553, Election by a Small Business Corporation, was filed on behalf of X effective D2. The election included a Qualified Subchapter S Trust (QSST) election under § 1361(d)(2) with respect to Trust. The Internal Revenue Service issued a Notice of "Acceptance as an S-Corporation" for X on D3 and an "Acceptance as a Qualified Subchapter S Trust" (QSST) for Trust on D4. Both the S corporation election and the QSST election were erroneously signed by A, the trustee of Trust, rather than B, the income beneficiary of Trust. For seven years after D1, A was legally appointed as the Limited Guardian of B under State law. The guardianship ended prior to D2, but X followed an established pattern and practice in dealing with A directly as the trustee of Trust and Limited Guardian of B when X obtained A's signature on the documents filed with the Internal Revenue Service.

Recently, representatives of X discovered that the Form 2553 and QSST election, effective D2, were signed by the wrong individual and initiated a request for a private letter ruling to correct the error. It is represented that Trust was eligible to elect QSST treatment under § 1361(d). Because of the signature error, the representatives of X are concerned that X's S corporation election was not effective on D2.

X represents that the error and the possible invalidity of its S corporation election were inadvertent and not motivated by tax avoidance. X and B further represent that at all times subsequent to D2, X, and its shareholders have treated X as an S corporation and filed returns as if Trust were a QSST. In addition, X and its shareholders agree to make such adjustments, consistent with the treatment of X as an S corporation and Trust as a QSST, as may be required by the Secretary.

Law

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) 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(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 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

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 the 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 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 under § 1361(d)(2) 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(f) provides that if (1) an election under § 1362(a) by any corporation (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 to obtain shareholder consents, 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 for which the election was made or the termination occurred is a small business corporation; and (4) the corporation for which the election was made or 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 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 termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that for purposes of § 1.1362-4(a), the determination of whether a termination or invalid election was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination or invalid election was inadvertent. The fact that the terminating event or invalidity of the election was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination or invalidity of the election was inadvertent.

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).

Section 1.1362-6(b)(1) provides that except as provided in §1.1362-6(b)(3)(iii), the election of the corporation is not valid if any required consent is not filed in accordance with the rules contained in §1.1362-6.

Section 1.1362-6(b)(2)(iv) provides that in the case of a trust described in § 1361(c)(2)(A) (including a trust under § 1361(d)(1)(A) as a trust described in § 1361(c)(2)(A)(i)), only the person treated as the shareholder for purposes of § 1361(b)(1) must consent to the election.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election was not effective on D2 due to the failure to obtain B's consent to the S corporation election and B's failure to sign the QSST election for Trust, and that the circumstances resulting in such ineffectiveness were inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will continue to be treated as an S corporation on and after D2, unless the S corporation election is otherwise terminated under § 1362(d), and Trust will be treated as a QSST (assuming that it otherwise qualifies as a QSST), provided that the following conditions are met.

Within one hundred twenty (120) days from the date of this letter, X must file a completed Form 2553 with the proper consents of all shareholders and B must file a QSST election effective D2 with the appropriate service center. A copy of this letter should be attached to the Form 2553 and QSST election.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be an S corporation or whether Trust is eligible to be a QSST.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it 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.

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

Sincerely,

James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure (2)

Copy of letter for § 6110 purposes
Copy of letter