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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.

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Date:
February 03, 2022

Legend

X =

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

A =

B =

Trust 1 =

Trust 2 =

Dear :

This letter responds to a letter dated July 16, 2021, and subsequent correspondence submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

Facts

The information submitted states that X was incorporated under the laws of State 1 on Date 1 and elected to be an S corporation effective Date 1. On Date 2, A, a shareholder of X, died. On Date 3, A's shares of X were transferred to Trust 1 pursuant to the terms of A's will. Trust 1 qualified as a permissible S corporation shareholder under § 1361(c)(2)(A)(iii) for a 2-year period beginning on Date 3, the day on which X stock was transferred to it. Pursuant to A's will, the trustees of Trust 1 were supposed to have transferred X stock to a separate trust (Trust 2) that was intended to be a qualified subchapter S trust (QSST) for the benefit of B because the governing provisions of Trust 1 did not satisfy the QSST requirements under § 1361(d)(3). However, the trustees of Trust 1 failed to transfer X stock to Trust 2 and B, the income beneficiary of Trust 2, failed to file a QSST election under § 1361(d)(2) for Trust 2. Consequently, on Date 4, Trust 1 became an ineligible shareholder of X and X's S corporation election terminated.

In late Date 5, X learned that its S corporation election terminated on Date 4 and that Trust 1 was an ineligible shareholder. Subsequently, trustees of Trust 1 petitioned a State 2 court to modify the terms of Trust 1 to ensure it qualified as a QSST effective Date 3. On Date 6, the State 2 court approved the requested modification. Before X stock was transferred to Trust 2 to effectuate the State 2 court-approved modification, X ceased to exist following a merger on Date 7.

X represents that at all relevant times, X and its shareholders have filed federal tax returns consistent with X being an S corporation. X represents that the termination of its S corporation election was inadvertent and was not motivated by a tax avoidance or retroactive tax planning. 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 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 an S corporation shareholder.

Section 1361(c)(2)(A)(iii) provides that, for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will may be an S corporation shareholder, but only for the two-year period beginning on the day on which such stock is transferred to it.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the beneficiary of such trust will be treated as the owner (for purposes of § 678(a)) 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)(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 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 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation ceases to be a small business corporation. A termination of an S corporation under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (2) the Secretary determines that the circumstances resulting in the 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 such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Rev. Rul. 93-79, 1993-2 C.B. 269, provides that a reformation of a trust to meet the requirements of a QSST is recognized prospectively.

Conclusion

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date 4 when Trust 1 became an ineligible shareholder. We further conclude that the termination of X's S corporation election on Date 4 was 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 from Date 4 until it ceased to exist following the merger on Date 7, provided that X's S corporation election was valid and has not otherwise terminated under § 1362(d).

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.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3) of the Code, 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 a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

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

Enclosure:

Copy of letter for § 6110 purposes

cc: