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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B3  
PLR-123713-21

Date:  
May 17, 2022

Legend

X =

Y =

State =

A =

Trust 1 =

Trust 2 =

Trust 3 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear \_\_\_\_\_ :

This letter responds to a letter dated November 1, 2021, submitted on behalf of X by its authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

### Facts

The information submitted states that X is a corporation which is a successor corporation of Y, was incorporated under the laws of State on Date 1. Y elected to be an S corporation effective Date 1. A was the sole initial shareholder of Y. On Date 2, A transferred all A's shares in X to Trust 1, a grantor trust that was treated (under subpart E of part I of subchapter J of chapter 1) as entirely owned by A. Trust 1 was an eligible shareholder under § 1361(c)(2)(A)(i). On Date 3, A died, causing Trust 1 to cease being a grantor trust. On Date 3, pursuant to terms of A's will, Trust 1 transferred its shares in X from Trust 1 to Trust 2. X represents that Trust 2 was qualified to be an Electing Small Business Trust ("ESBT"), within the meaning of § 1361(e), however, no election was made under § 1361(e)(3) to treat Trust 2 as an ESBT. Consequently, Trust 2 was an ineligible shareholder, and, as a result, X's S corporation election terminated on Date 3.

On Date 4, Trust 2 transferred its shares in X to Trust 3. X represents that beginning Date 4, Trust 3 qualified as a qualified subchapter S trust ("QSST") under § 1361(d)(3). However, Trust 3 filed an erroneous QSST election.

X represents that there was no tax avoidance or retroactive tax planning involved in the failure of Trust 2 to make a timely ESBT election. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation and Trust 2 as eligible shareholders, 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)(B) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other requirements, 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(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 of the Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the 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), 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)(A) provides that a beneficiary of a QSST may elect to have § 1361(d)(1) apply.

Section 1361(d)(2)(D) provides that an election under § 1362(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) provides that 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 only be 1 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 such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or a 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 a QSST 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 including the information listed in § 1.1361-1(j)(6)(ii).

Section 1361(e)(1)(A) provides that, for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term “electing small business trust” means any trust if - (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2) - (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides, in part, that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center for which the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1.1361-1(m)(2)(iii) provides that the ESBT election must be filing within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a qualified subchapter S trust (QSST) election.

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)(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) or § 1361(b)(3)(B)(ii) by any corporation (i) 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 (ii) was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C); (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 or a QSub, as the case may be, or to acquire the required shareholder consents; and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agree to make the adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation or a QSub, as the case may be, 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 3 when Trust 2 became an ineligible shareholder, and that the termination was inadvertent within the meaning of § 1362(f). We also conclude that Trust 3 substantially complied with the requirements for an election to be treated as a QSST under § 1.1361-1(j)(6)(ii). Consequently, we rule that X will be treated as an S corporation from Date 3 and thereafter provided that X's S corporation election is otherwise valid and not otherwise terminated under § 1362(d).

These rulings are contingent on the trustee of Trust 2 filing an ESBT election effective Date 3 with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to the ESBT election. Additionally, X and its shareholders must file any original and amended returns for all open taxable years consistent with the relief granted in this letter. If the above conditions are not met, then this ruling is null and void.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was otherwise a valid S corporation, whether Trust 2 is a valid ESBT within the meaning of § 1361(e)(3), or whether or Trust 3 is a valid QSST within the meaning of § 1361(d)(3).

The rulings contained in this letter are 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 rulings requested, it is subject to verification on examination.

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

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

Sincerely,

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

Enclosure:

Copy for § 6110 purposes

cc: