

Internal Revenue Service

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Washington, DC 20224

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LEGEND

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Trust =

A =

Year 1 =

Dear :

This letter responds to a letter dated February 17, 2022, submitted on behalf of X by its authorized representatives requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

Facts

According to the information submitted, X was incorporated under the laws of State on Date 1 and made an election to be treated as an S corporation effective Date 2. On Date 3, shares of X stock were transferred to Trust. It is represented that as of Date 3, Trust satisfied the qualified subchapter S trust (QSST) requirements under § 1361(d)(3). However, in Year 1, X learned that A, the income beneficiary of Trust, had failed to make an election under § 1362(d)(2) to treat Trust as a QSST effective Date 3. Consequently, Trust was an ineligible shareholder of X and X's S corporation election inadvertently terminated on Date 3. Subsequently on Date 4, Trust distributed all of its shares of X stock to A.

X represents that X and its shareholders have filed tax returns consistent with X having a valid S corporation election in effect as of Date 2. X also represents that both Trust and A have filed tax returns in a manner consistent with Trust having valid a QSST election in effect from Date 3 to Date 4. X and its shareholders have agreed to make any adjustment that the Commissioner may require, consistent with the treatment of X as an S corporation.

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, in part, that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which 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(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(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)(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 § 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. A substantially separate and independent share of a trust within the meaning of § 663(c) shall be treated as a separate trust for purposes of § 1361(d)(3) and § 1361(c).

Section 1.1361-1(j)(7)(i) of the Income Tax Regulations provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

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 taxable year for which a 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 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 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 was terminated under § 1362(d)(2), (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 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 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 such ineffectiveness or termination, such 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 status inadvertently terminated on Date 3 when Trust became an

ineligible shareholder. We further conclude that the circumstances resulting in the termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Pursuant to the provisions § 1362(f), we rule that X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided that X's S corporation election was valid and not otherwise terminated under § 1362(d) for reasons not addressed in this letter. In addition, Trust will be treated as a QSST from Date 3 until Date 4.

This ruling is contingent on A, as the beneficiary of Trust, filing a QSST election for Trust, effective Date 3, 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 above, we express or imply no opinion as to the federal income tax consequences of the facts described above under any other provision of the Code, including whether X was otherwise a valid S corporation or whether Trust was a valid QSST.

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

The ruling contained in this letter is based on 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 representatives.

Sincerely,

Jennifer N. Keeney
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure
Copy for § 6110 purposes

cc: